MAKE MONEY WITH

PRICE ACTION TRADING

Technical Analysis Simplified!

SUNIL GURJAR

CONTENT

INTRODUCTION TO PRICE ACTION TRADING

Price Action:

The term 'Price Action' refers to the price movement which happens in any security in a given period of time.

"Jesse Livermore" was one of the most significant practitioners of Price Action Analysis. He was the one who invented Price Action Trading in the 20^{th} Century.

The fundamental belief of price action is that price never lies, so price action methodology removes all the technical indicators and only basic price movement data is used to generate entry and exit signals for trade.

Price Action is one of the branches or a part of technical analysis which makes use of only the past and the current price to predict the future price movement of any security.

Price Action Trading:

Price Action Trading is also known as "Clean Chart Trading". Price Action Trading takes place when you base your trading decision (buying and selling) on the price behavior of any security.

In Gujarati, there is a famous saying related to the Stock Market which is the essence of Price Action Trading - *"Bhav Bhagwan Che"* which means "Price is Supreme".

Price Action Trader focus on ***"what has happened"*** and ***"what is happening"*** in the market as opposed to ***"why it is happening"***.

As mentioned earlier, Price Action Trading is normally based on the naked price chart without making use of any indicators like oscillators, pivot points, moving averages, etc.

A Price Action Trader does not give much weightage to "Technical Indicators" like MACD, RSI, ADX and so on.

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A Price Action Trader is only concerned with past and current price data points which include Open, High, Low, Close price and hence Price Action Traders mainly use Candlestick Charts or Bar Charts.

Price Action Trading is purely based on the concept of demand and supply.

If the price of any security goes up it simply means that there are more buyers than sellers which pushes the price of the security higher. In other words, demand is higher than supply. Similarly, if the price of any security goes down it simply means that there are more sellers than buyers which pushes the price of the security lower. In other words, supply is higher than demand.

On the next page, I have presented two charts, one showing just price action and another one loaded with indicators along with the price.

Chart below is NIFTY 50 Daily Price Action Chart which shows a clear picture of the price movement of the index in a simple manner.

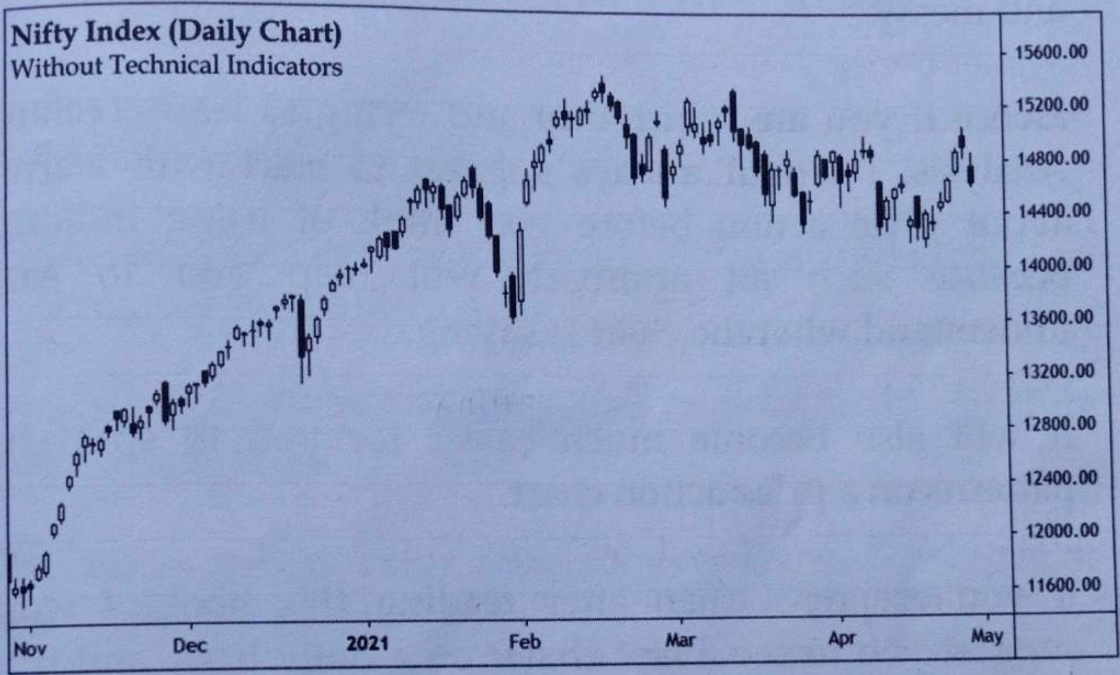
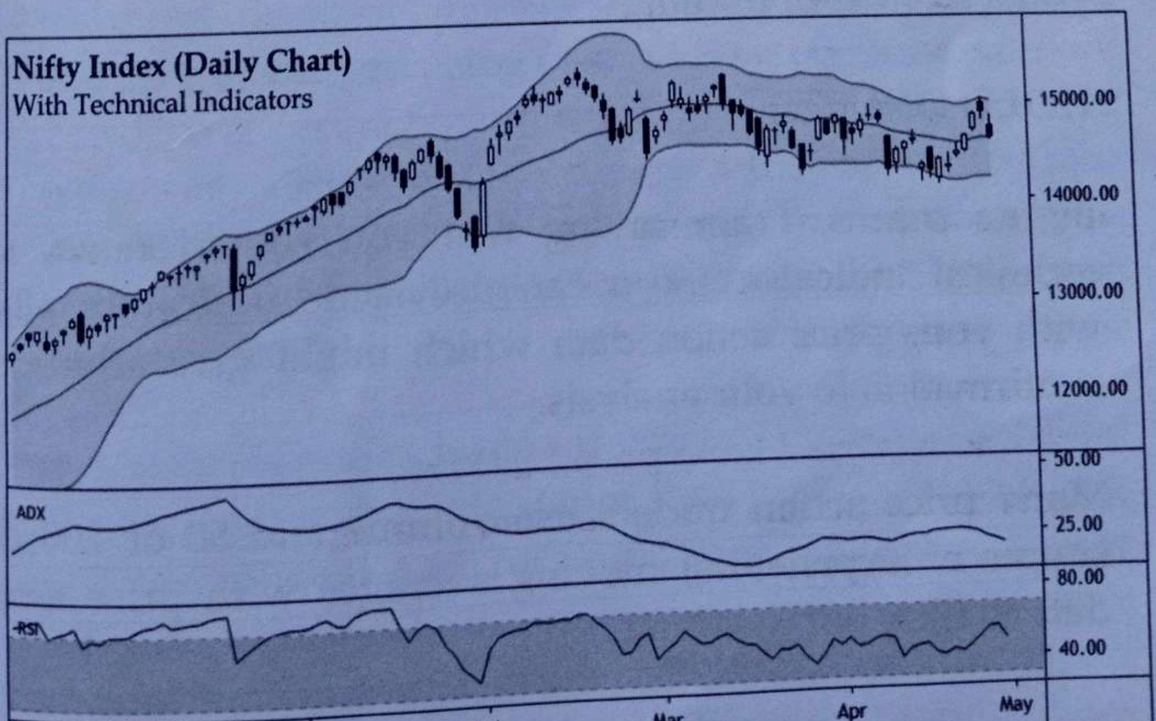


Chart below is NIFTY 50 Daily Chart loaded with commonly used Technical Indicators like Bollinger Bands, ADX and RSI.



Now by looking at both the charts, I am sure you will say that the first chart is easy to read and understand while the second chart loaded with indicators looks a bit confusing and messy.

Hence if you are a beginner and trying to learn Technical Analysis, I would always suggest to start with learning about price action before you think of using indicators because such an approach will help you to easily understand what the chart is saying.

आसान

It will also become much easier for you to spot chart patterns on a price action chart.

If you are new, then after reading this book, I would suggest you to see a few charts on a daily basis and try to analyze them as to what candlesticks are saying and spot chart patterns in them.

Slowly but surely you will gain confidence, which will help you a lot in your trading.

HOLD ON!

By no means, I am saying that you should never use technical indicators. You can use some indicators along with your price action data which might give additional confirmation to your analysis.

Many price action traders use volume and 50 or 200 day simple or exponential moving averages with price action data to filter out the trend.

Basic Principles of Price Action Trading :

Before proceeding further, let me list out the main concepts or principles on which price action trading is based.

1. Support and Resistance
2. Candlesticks and Chart Patterns
3. Trends
4. Market Reaction (Price Rejection, Price Acceptance)
5. Structure of the Market

All these concepts will be discussed in detail in the chapters ahead in this book.

Now let us look at some advantages and disadvantages of Price Action Trading.

Advantages of Price Action Trading :

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1. **It helps you to trade in real time -** Price Action gives you the edge in real time frame as it does not include technical indicators most of which are lagging in nature as they are derived using past price and volume data.

2. **Easy to understand -** As explained earlier, पहले understanding price action is an easy task because you are only looking at just price data points, which makes it easy to identify.

3. **It is very simple to trade -** If you can understand where to plot support and resistance then price action trading will become very easy for you. I have seen many people using a cluster of indicators and then identifying where to put buy and sell order which becomes a hurdle बाधा especially for newcomers because you have messed up

विशेषकर नये चेहरे

with your trading setup and that is the reason I always believe in keeping the trading setup very simple and to my mind, 'it is a must' thing to do in the trading parlance. बोल-चाल

4. **It is back tested and time tested strategy** - The main principles of price action trading such as trends, support and resistance have been back tested from many years and I have been using these simple setups over the last many years. It works very well as far as my understanding goes.

5. **It provides clear entry and exit levels** - By using the concept of support and resistance which is the heart and backbone of price action trading, you can see proper demand and supply zones and can easily identify entry and exit levels for your trades.

Disadvantages of Price Action Trading :

असंगत आम सहमति

1. **Contradictory in terms of consensus view** - Price action often gives different signals on different time frames, which may create confusion to newcomers. For example in case of a particular stock when analyzed on different time frames, I might see a Bullish Marubozu and you might spot a bullish engulfing or you might find trend line support and I might find the horizontal support. Hence one has to be very careful.

2. **It gives false signals** - Using price action will not always give you correct signals (Which none of the setup or strategy gives). It is not that you will be able to make money on every trade you do, so you have to learn to stay with false signals.

3. **Provides very few trading opportunities** - The number of opportunities you will get will be very few in case of price action trading as compared to trading based on indicators. So you have to make sure that you will wait for the right opportunity and then act on it. Hence it is often said that price action trading is a waiting game and requires patience.

4. **Sometimes signals are difficult to predict** - A person who is completely new to trading or technical analysis might find price action trading to be tough in the form of bullish and bearish candle or chart patterns as compared to indicator based trading.

Now when it comes to trading in the stock market or any other financial market, remember this quote of famous American investor and writer, Howard Marks –

"There's no magic formula for being on top."

Eventually, you have to see which system and style is working best for you and based on that you have to decide which style of trading suits you – Price Action Trading or Indicator Based Trading.

I shall conclude this introductory chapter with an important advice for all newcomers -

"Never think of becoming a billionaire or making tons of money overnight because that is never going to happen."

SUPPORT AND RESISTANCE

पहलु

Among all the aspects of technical analysis, perhaps the most important concept is support and resistance. Many other aspects of technical analysis are based on these concepts. Hence before proceeding further, we first need to understand this concept thoroughly. अच्छी तरह से

आगे बढ़ना

Support and **Resistance** are the important price points on the chart of any security at which the security is expected to attract the maximum amount of buying or selling.

They are the points where there is a maximum probability of a pause or a reversal, of a prevailing trend. The logic behind them is demand and supply.

The price of any financial asset or security is driven due to the law of demand and supply. When the demand (buyers) is more than the supply (sellers) price of a security increases and when the supply (sellers) is more than the demand (buyers) price of a security decreases.

The age old saying of ***'Buy Low and Sell High'*** is the only thing that is required to make money in any financial market (stocks, commodities, currencies, cryptocurrencies, etc.) This is precisely where support and resistance come into the picture. For this, one has to either buy at support and later on sell at resistance or sell at resistance and buy back later at support.

Most of the financial market traders use the concept of support and resistance as an important factor while trading in the market, be it scalping, day trading, swing trading or positional trading.

What is Support?

As the term suggests, it is the level at which the price of a security does not fall further as the demand is sufficient enough to hold the price from falling further.

As explained earlier, when supply is more than demand, the price of a security decreases. Now as price reaches near the support level, more and more buyers get keen to buy the security whereby demand becomes more than supply and hence price stops from falling further and starts rising.

Support will always appear or form below the current market price of a security.

Support can either be in form of a single price level or a zone. This point shall be clear when you look at examples ahead in this chapter.

Support level or zone ultimately gives us the reference point where the most repetitive buying (demand) has happened in the past and is likely to happen again in the future. It is an important technical level from market participant's point of view.

How to Plot Support Level or Zone?

The following steps are to be followed to correctly plot the support level or zone.

1. Look at the historical price data.
2. Identify extreme lows.
3. Mark all the low touch points.
4. Connect all the touch point.

1. **Look at the historical price data** - The first thing you need to do is to look at the past price data of a security whose support level you want to find.

   You can either use a candlestick chart or an OHLC bar chart for this process. Never use a line chart as it does not take into account open, high and low prices of a trading day.

   I always prefer using candlestick charts, as they are the simplest of all forms of chart and provide all the necessary information.

2. **Identify extreme lows** - Try to find extreme lows i.e., price points or zones from where price of a security turns in an upward direction more often.

   Here price point refers to a particular point from where there has been a sharp reversal in price whereas the price zone refers to a zone in which a price gets stuck after a brief down move. अटकना
   संक्षिप्त

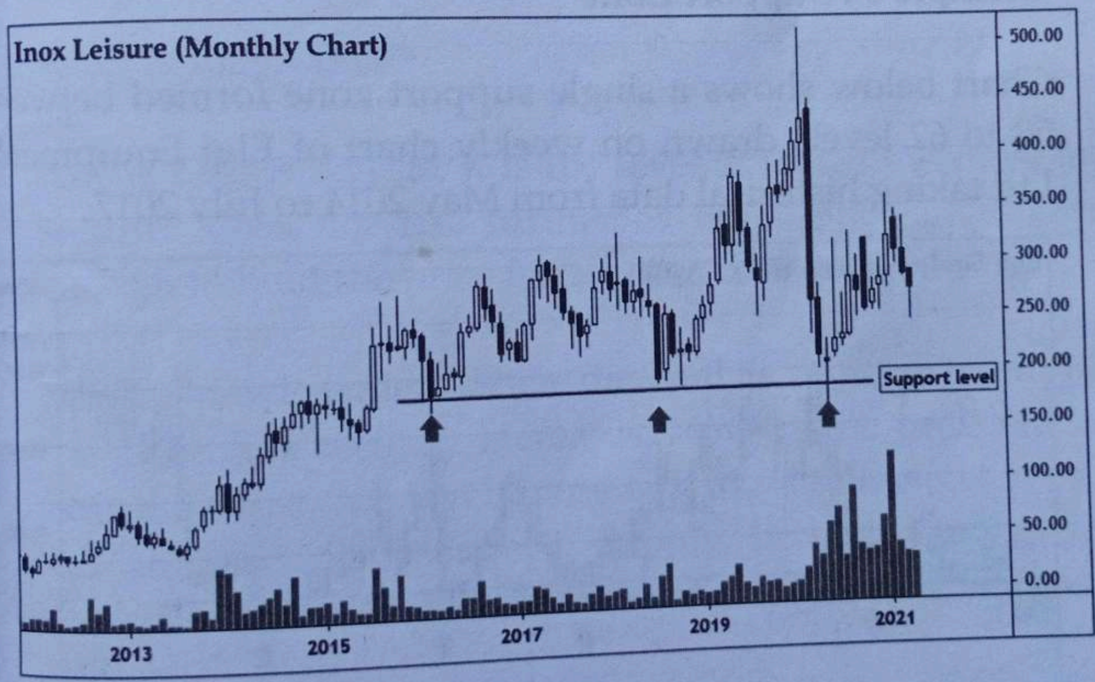
3. **Mark all the low touch points** - When you are done identifying the extreme lows for support level then you have to mark or encircle these levels so that they become more visible and easy to understand. Try to find at least 3 or more such points.

4. **Connect all the touch point** - Once you are done marking all the touch points, next step is to connect all those touch points.

Now depending on the price action and time period of the data, these touch points will get connected through one or more horizontal lines or through one or more horizontal rectangular zones such that you either get a single support level, multiple support levels, a single support zone or multiple support levels as shown in examples below.

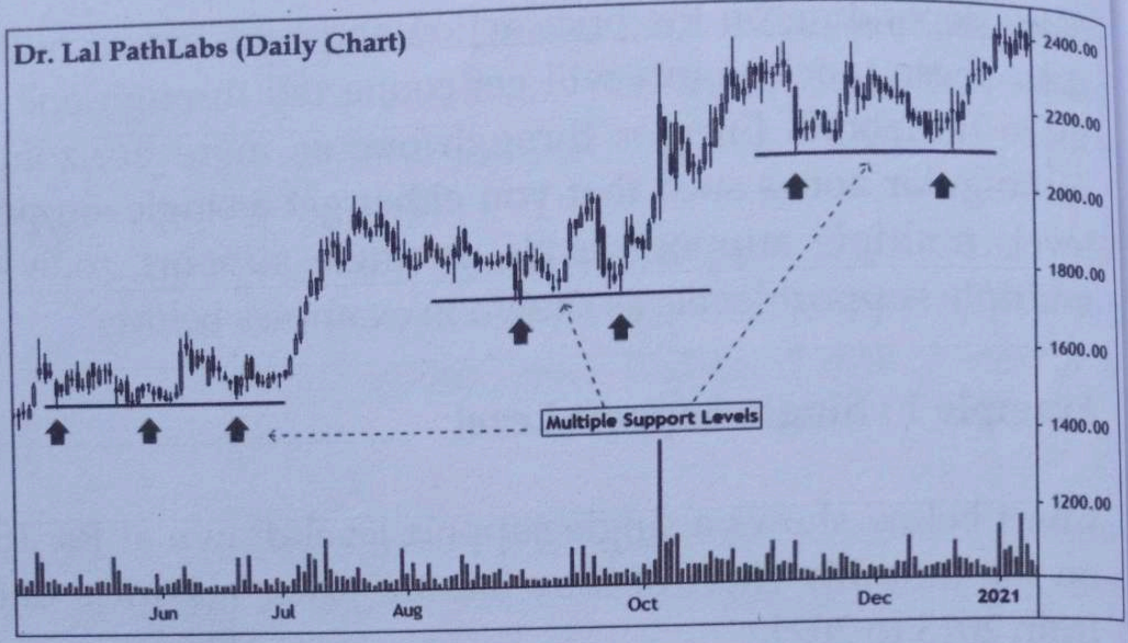
Example 1 : Single Support Level

Chart below shows a single support level drawn at Rs. 184 on the monthly chart of Inox Liesure using historical data from 2013 to 2021.



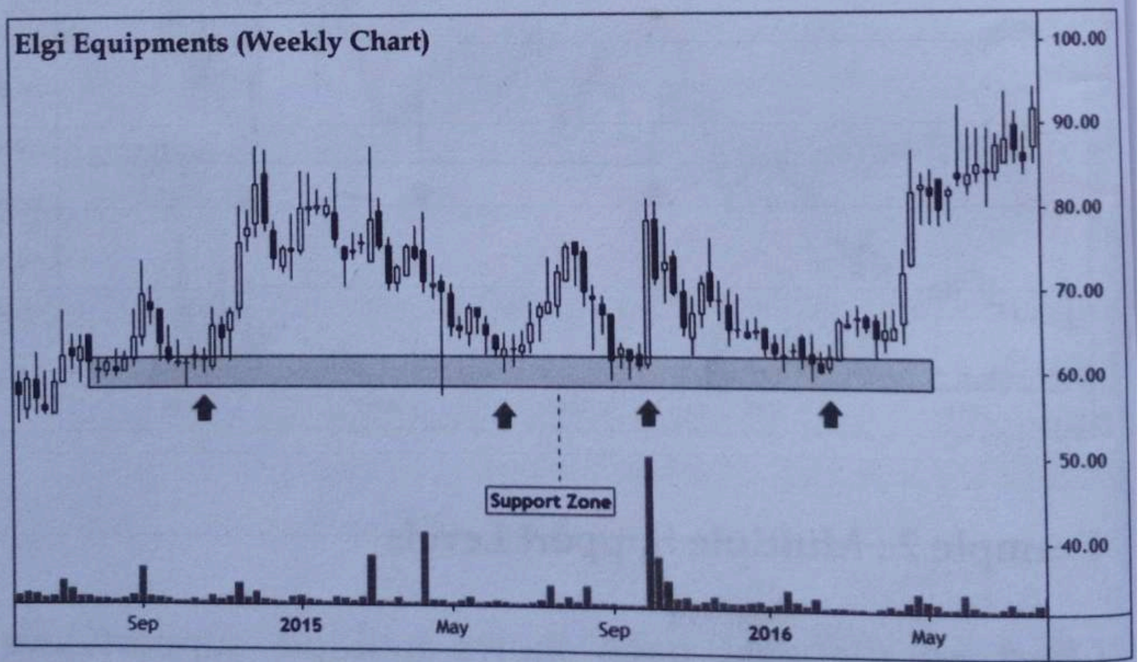
Example 2 : Multiple Support Levels

Chart on the next page shows multiple support levels drawn on the daily chart of Dr. Lal Pathlabs Ltd using historical data from April 2020 to Jan 2021.



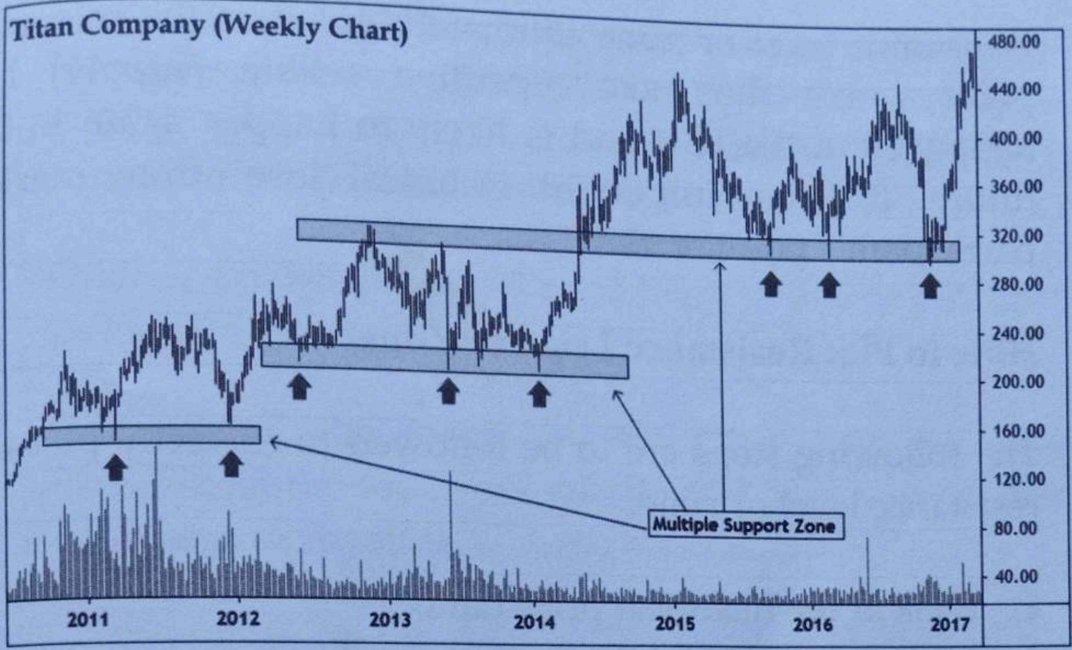
Example 3 : Support Zone

Chart below shows a single support zone formed between 58 to 62 levels drawn on weekly chart of Elgi Equipments Ltd taking historical data from May 2014 to July 2017.



Example 4 : Multiple Support Zones

Chart on the next page shows multiple support zones drawn on the weekly chart of Titan Company using historical data from June 2020 to March 2017.



What is Resistance?

As the term suggests, it is the level at which the price of a security does not rise further as the supply is sufficient enough to hold the price from rising further.

As explained earlier, when demand is more than supply, the price of a security increases. Now as the price reaches near the resistance level, more and more sellers get keen to sell the security whereby supply becomes more than demand and hence price stops from rising further and starts falling.

Resistance will always appear or form above the current market price of a security.

Resistance can either be in form of a single price level or a zone. This point shall be clear when you look at examples ahead in this chapter.

Resistance level or zone ultimately gives us the reference point where the most repetitive selling (supply) has happened in the past and is likely to happen again in the future. It is an important technical level from market participant's point of view.

How to Plot Resistance Level or Zone?

The following steps are to be followed to correctly plot the resistance level or zone.

1. Look at the historical price data.
2. Identify extreme highs.
3. Mark all the high touch points.
4. Connect all the touch point.

The process followed in plotting resistance level or zone is similar to that followed in case of plotting support level or zone with the only difference being instead of identifying and connecting extreme lows, here our focus is on extreme highs. Still, I shall explain the process once again.

1. **Look at the historical price data** - The first thing you need to do is to look at the past price data of a security whose resistance level you want to find.

2. **Identify extreme highs** - Try to find extreme highs i.e., price points or zones from where the price of a security turns in a downward direction more often.

   Here the price point refers to a particular point from where there has been a sharp reversal in the price whereas price zone refers to a zone in which a price gets stuck after a brief up move.

3. **Mark all the high touch points** - When you are done identifying the extreme highs for resistance level then you have to mark or encircle these levels so that they become more visible and easy to understand.

   Once again, here also you need to try to find at least 3 or more such points.

4. **Connect all the touch point** - Once you are done marking all the touch points, the next step is to connect all those touch points.

Now depending on the price action and time period of the data, these touch points will get connected through one or more horizontal lines or through one or more horizontal rectangular zones such that you either get a single resistance level, multiple resistance levels, a single resistance zone or multiple resistance levels as shown in examples ahead.

Example 1 : Single Resistance Level

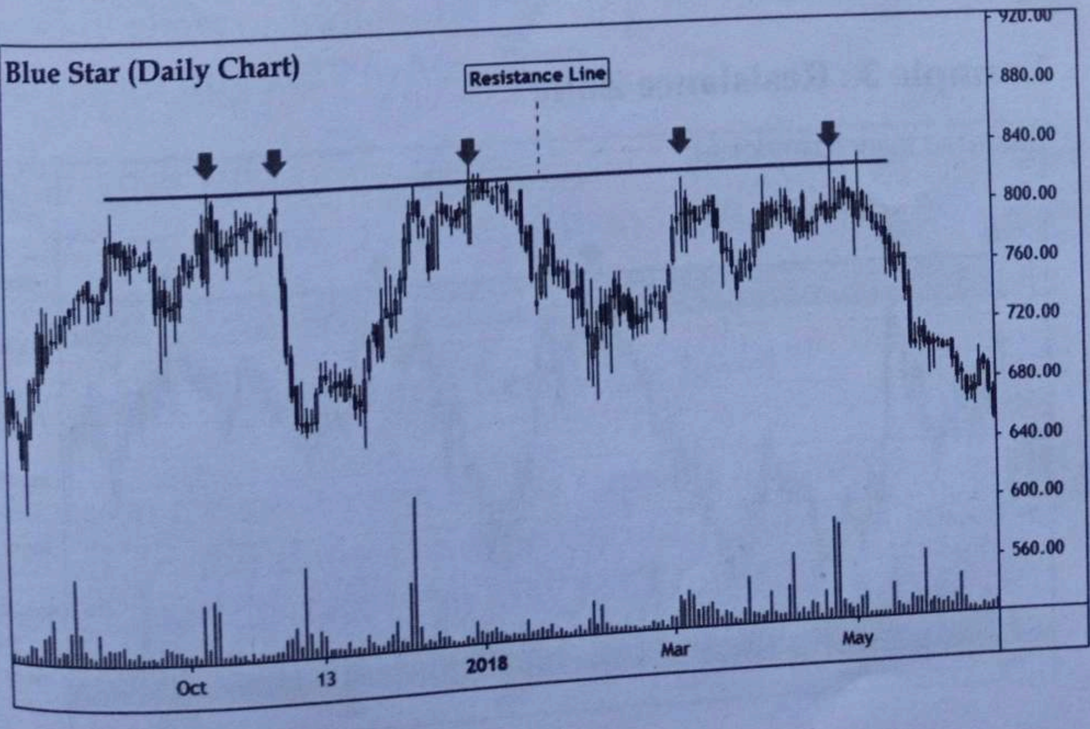


Chart on the previous page shows a single resistance level drawn at level of 830 on the daily chart of Blue Star using historical data from September 2017 to June 2018.

Example 2 : Multiple Resistance Levels

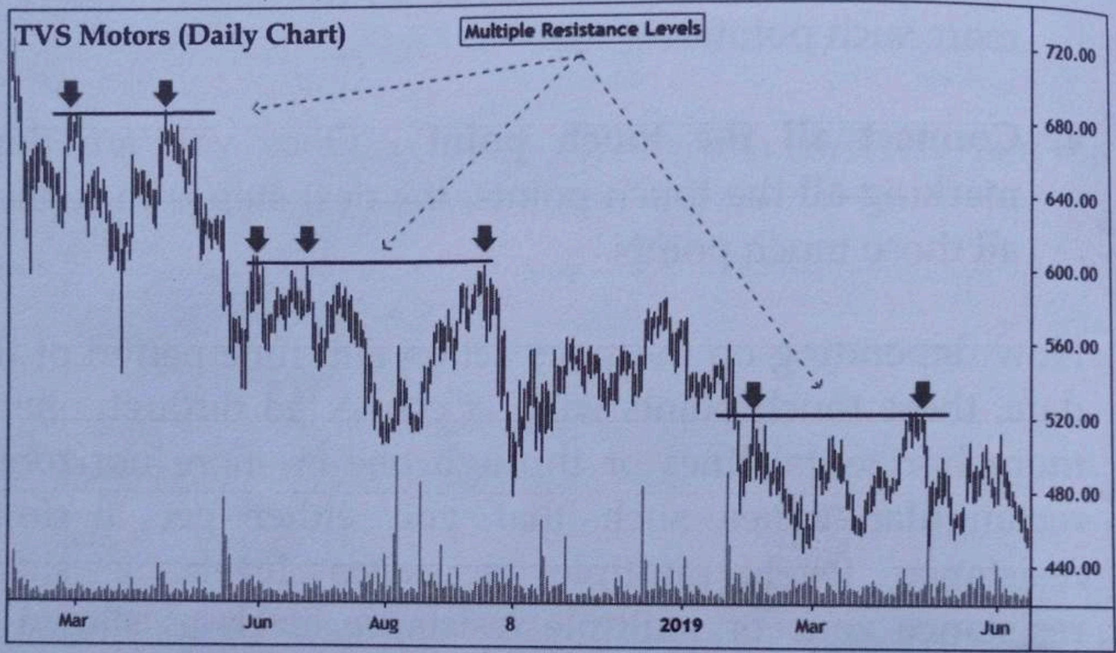


Chart above shows multiple resistance levels drawn on the daily chart of TVS Motor using historical data from January 2018 to June 2019.

Example 3 : Resistance Zone

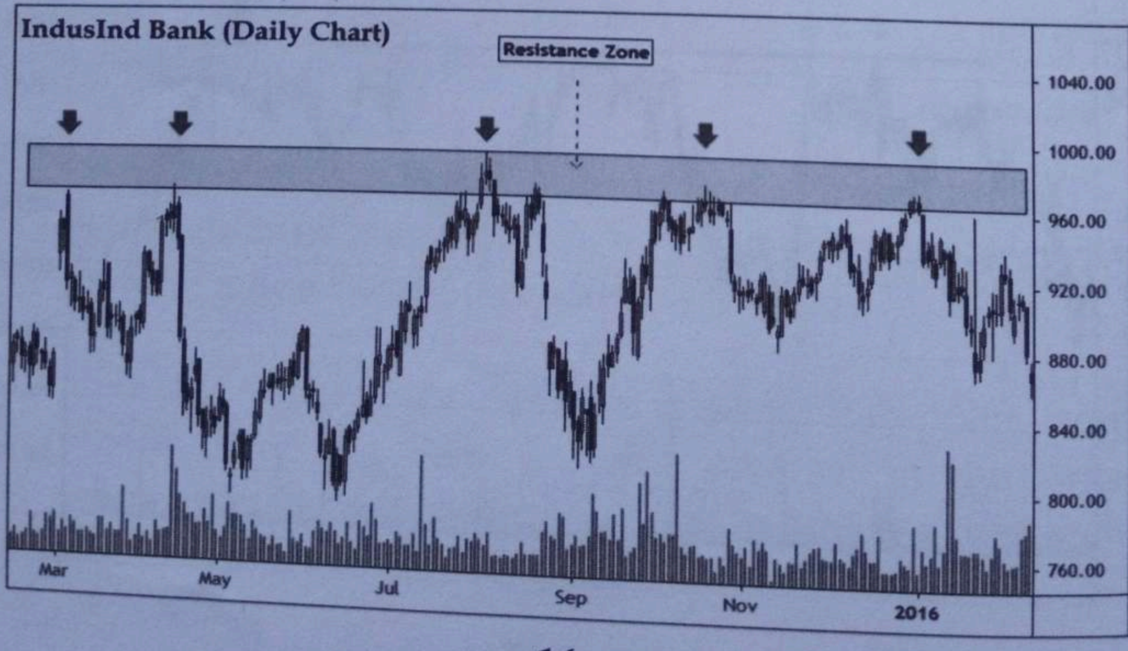


Chart on the previous page shows a single resistance zone formed between 965 to 990 levels drawn on the daily chart of Indusind Bank Ltd using historical data from February 2015 to February 2016.

Example 4 : Multiple Resistance Zones

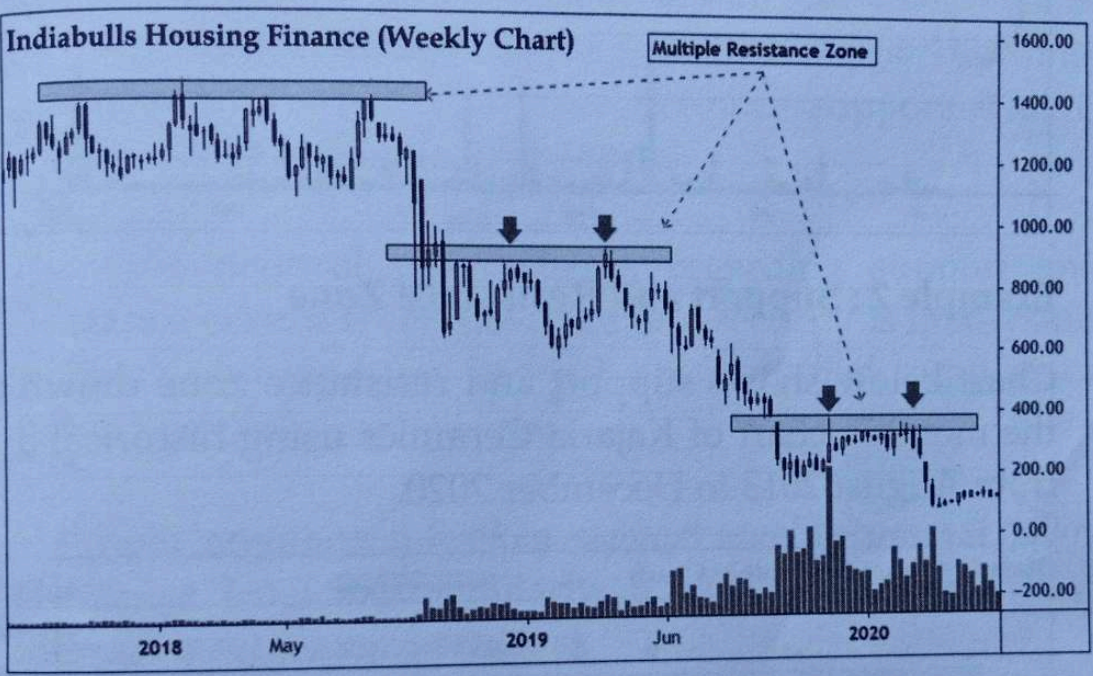
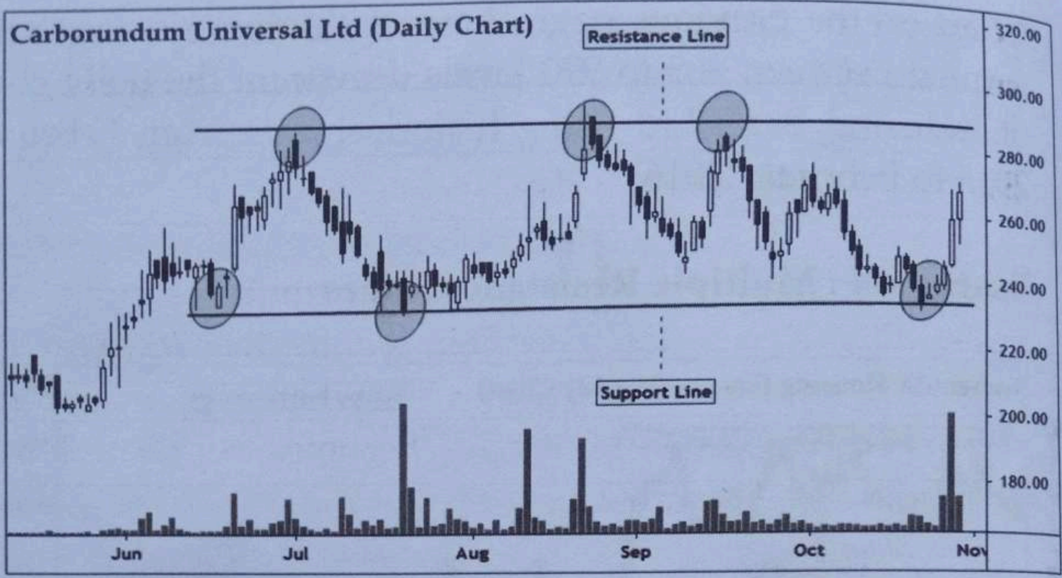


Chart above shows multiple resistance zones drawn on the weekly chart of Indiabulls Housing Finance using historical data from July 2017 to May 2020.

Now after having understood the concept of support and resistance, below I have shown some more examples showing both support and resistance on the same chart.

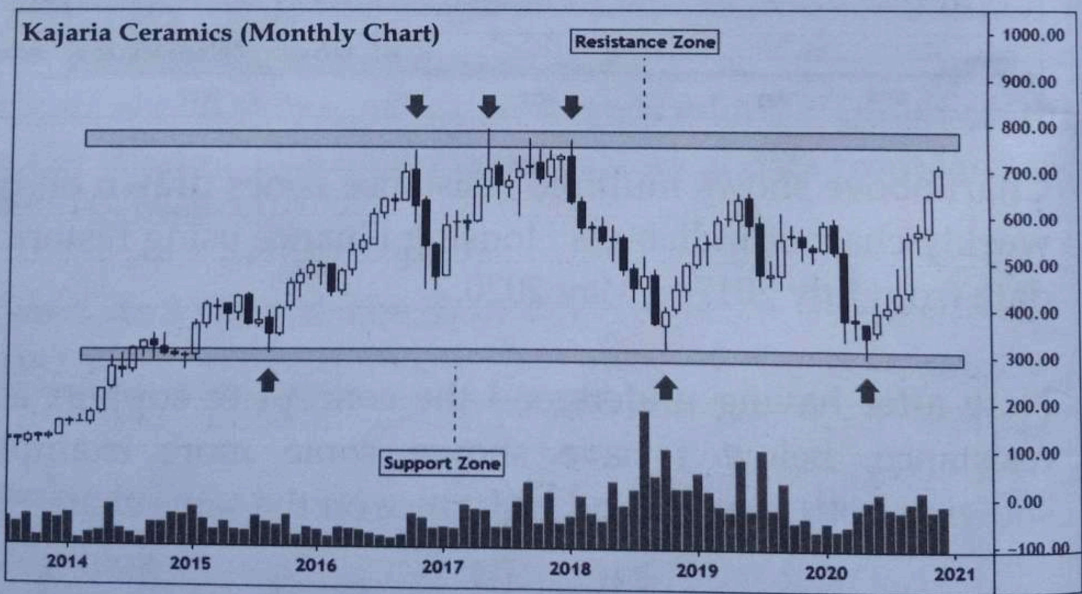
Example 1 : Support and Resistance Level

Chart on the next page shows support and resistance level drawn on the daily chart of Carborundum Universal Ltd using historical data from May to October 2020.



Example 2 : Support and Resistance Zone

Chart below shows support and resistance zone drawn on the monthly chart of Kajaria Ceramics using historical data from August 2013 to December 2020.



Important Point to Remember :

Support and resistance are just reference points used for buying and selling securities. However, in trading they should be used alongwith other things like candlestick pattern, chart patterns, etc to get better confirmation.

Now let us proceed to an important concept regarding support and resistance, i.e., how they reverse their roles.

Support and Resistance Reversal:

Earlier I explained how to draw simple support and resistance, now I shall explain about the role reversal between support and resistance i.e., when support becomes resistance and when resistance becomes support. This is known as ***The Principle of Polarity***.

तत्व तथ्य

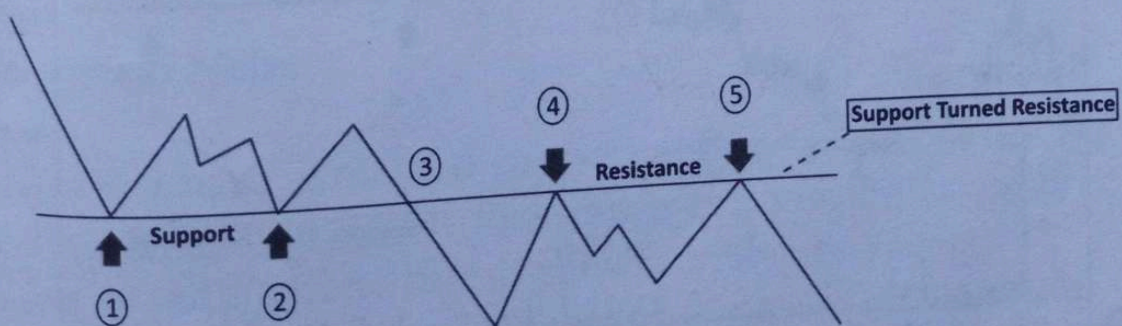
This role reversal phenomenon regarding support and resistance occurs when the price of a security is finally able to break out and go beyond an identified support or resistance level.

आगे

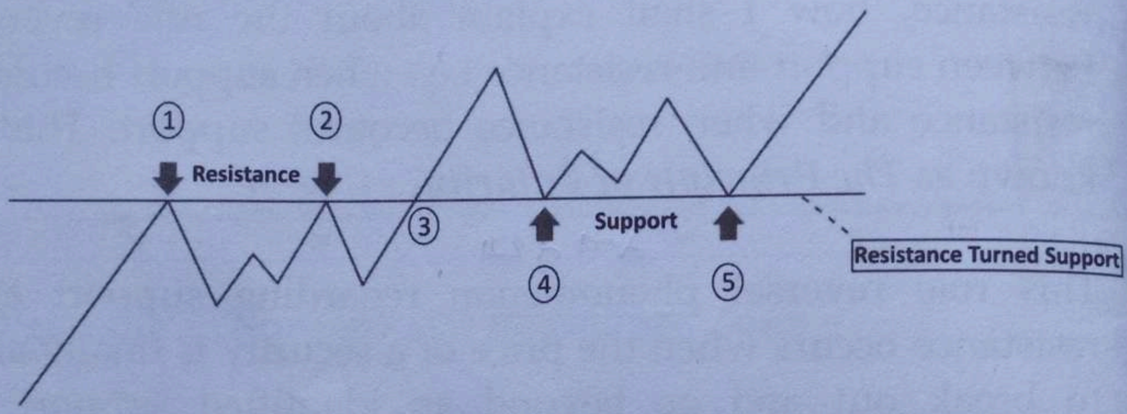
In simple language, ***a broken support level becomes a future resistance level*** and similarly, ***a broken resistance level becomes a future support level***.

विचार करना

Consider an example wherein a security after taking a support at a particular level multiple times (point 1 & 2) breaks the support level (point 3) and falls further. Now in the future when the price rises and comes back to the earlier support level, then this time around the same level will act as a resistance (point 4 & 5).



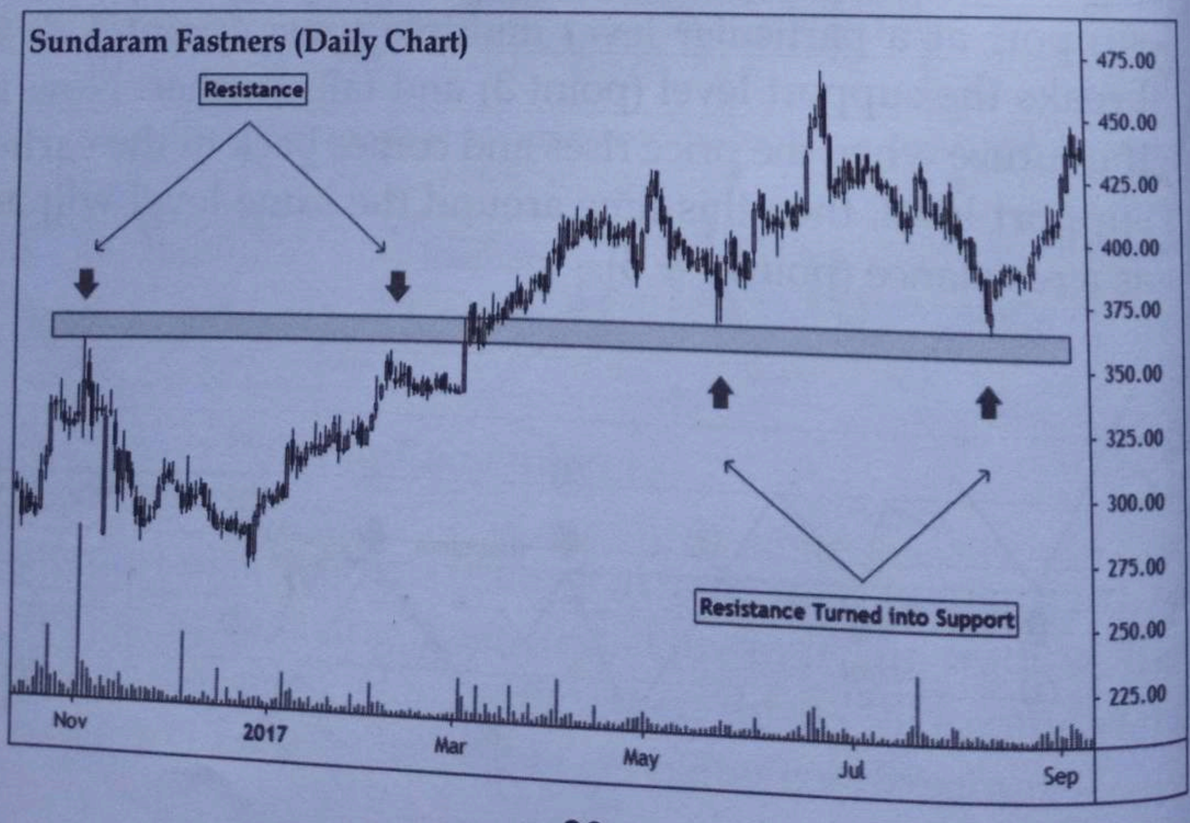
Consider an example wherein a security after facing a resistance at a particular level multiple times (point 1 & 2) breaks the resistance level (point 3) and rises further. Now in the future when the price falls and comes back to the earlier resistance level, then this time around the same level will act as a support (point 4 & 5).



Below I have shown a few practical examples which will help you to understand the concept in a better manner.

Example 1 : Resistance Turned Support

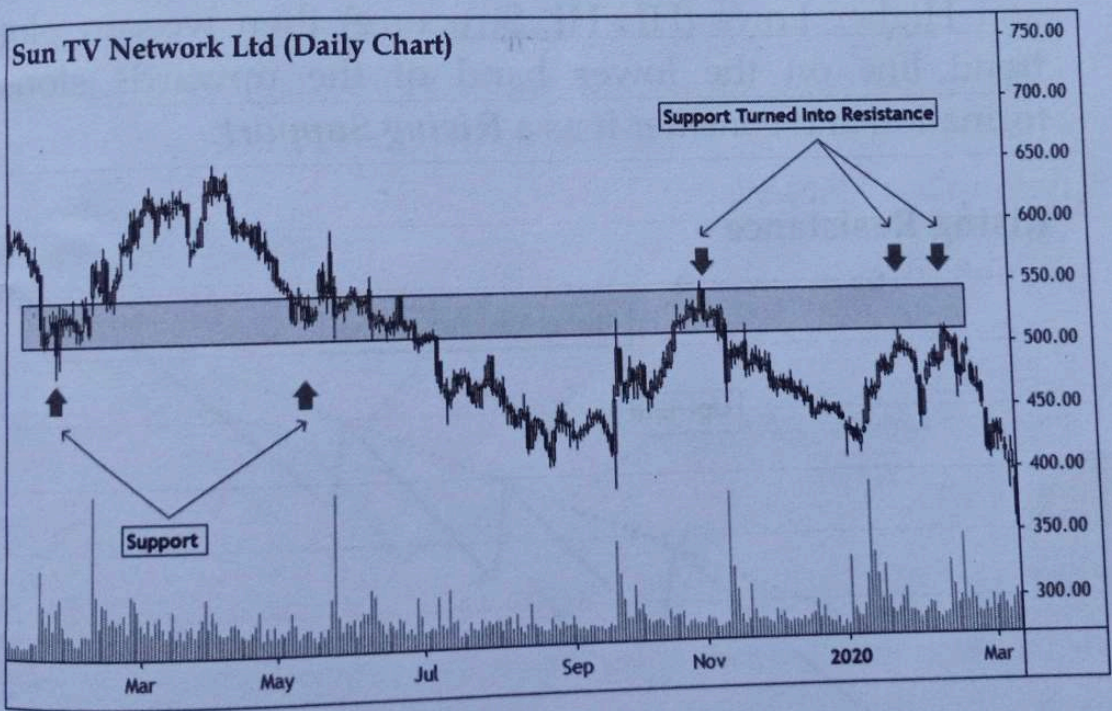
The chart below shows the daily price action of Sundaram Fastners from October 2016 to September 2017.



The resistance zone between 355 and 365 levels got broken in March 2017 and later on it acted as an important support level on two occasions in May 2017 and August 2017 respectively.

Example 2 : Support Turned Resistance

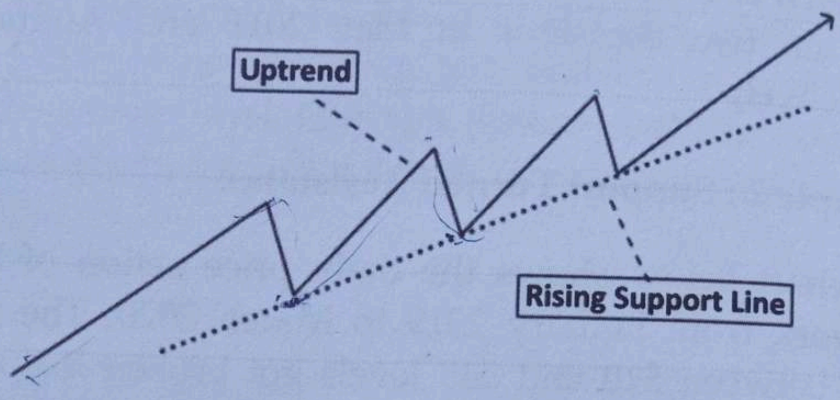
The chart below shows the daily price action of Sun TV Network from January 2019 to March 2020. The support zone between 510 and 545 levels got broken in June 2019 and later on it acted as an important resistance level on three occasions in November 2019, January 2020 and February 2020 respectively.



Important Note:

Till now I have explained support and resistance which are horizontal. Support and Resistance can also be in form of rising or falling trend line as shown on the next page.

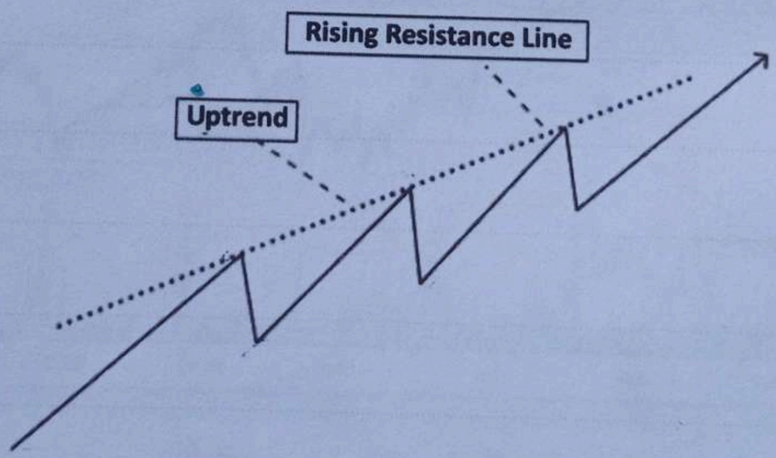
Rising Support -



Rising Support

When the price of any security goes up in Higher Highs and Higher Lows (HH-HL Structure) then we can plot a trend line on the lower band of the upwards sloping formation and consider it as a ***Rising Support***.

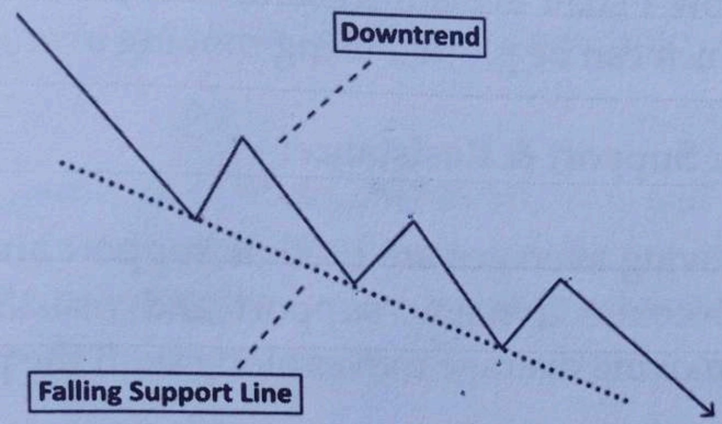
Rising Resistance –



Rising Resistance

When the price of any security goes up in Higher Highs and Higher Lows (HH-HL Structure) then we can plot a trend line on the higher band of the upwards sloping formation and consider it as a ***Rising Resistance***.

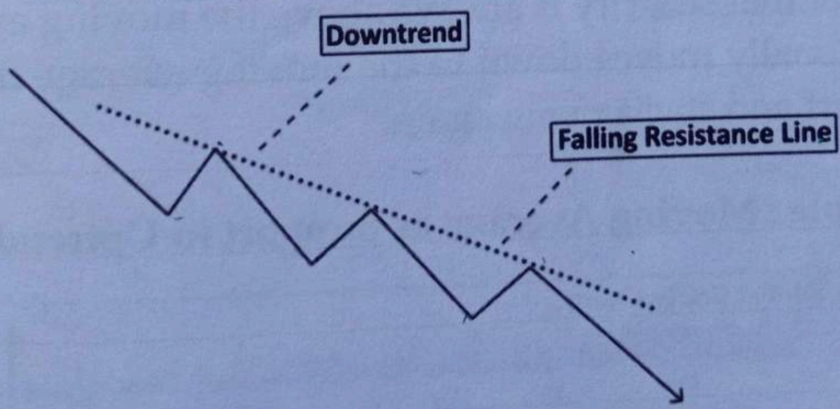
Falling Support -



Falling Support

When the price of any security goes down in Lower Lows and Lower Highs (LL-LH Structure) then we can plot a trend line on the lower band of the downward sloping formation and consider it as a ***Falling Support***.

Falling Resistance -



Falling Resistance

When the price of any security goes down in Lower Lows and Lower Highs (LL-LH Structure) then we can plot a trend line on the higher band of the downward sloping formation and consider it as a ***Falling Resistance***.

Till now I have explained support and resistance which are static. Now I shall explain dynamic support and resistance levels which can be plotted using moving averages.

Dynamic Support & Resistance:

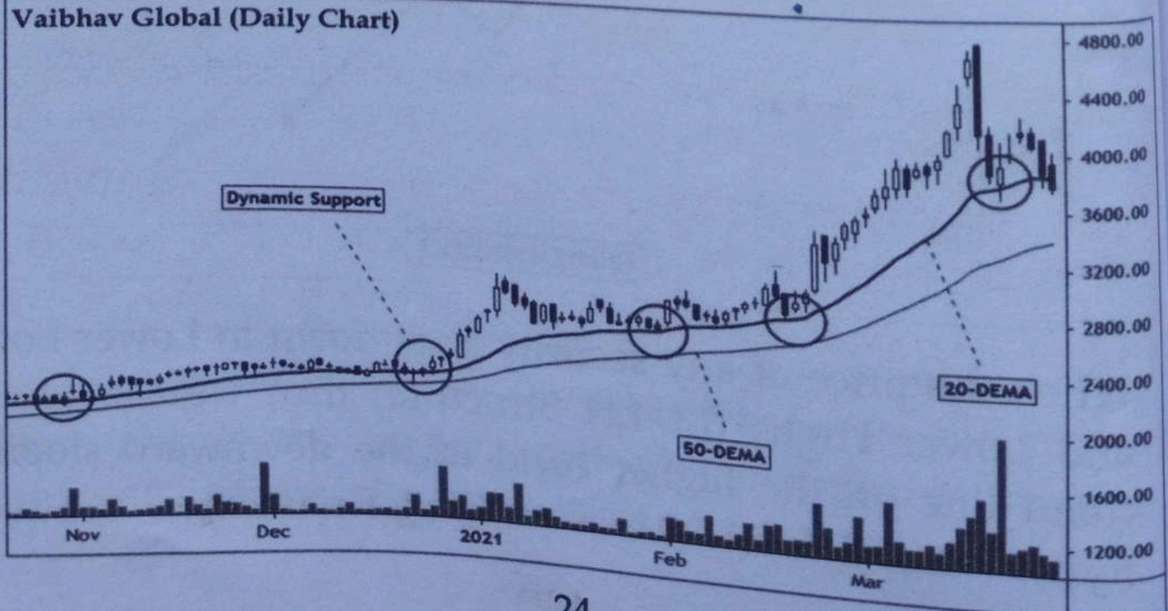
When moving averages are used as support and resistance then it becomes dynamic support and resistance. This is because moving average moves along with the price.

Dynamic support occurs in an uptrend while dynamic resistance occurs in a downtrend.

Commonly used moving averages for short term are 20 and 50 day moving averages while 100 day moving average is commonly used for medium term and 200 day moving average is used for long term.

When any security is in an uptrend, you will notice that the price of that security is always above the moving average. It occasionally moves down to the moving average line, takes support and starts rising again.

Example : Moving Average as Support in Uptrend

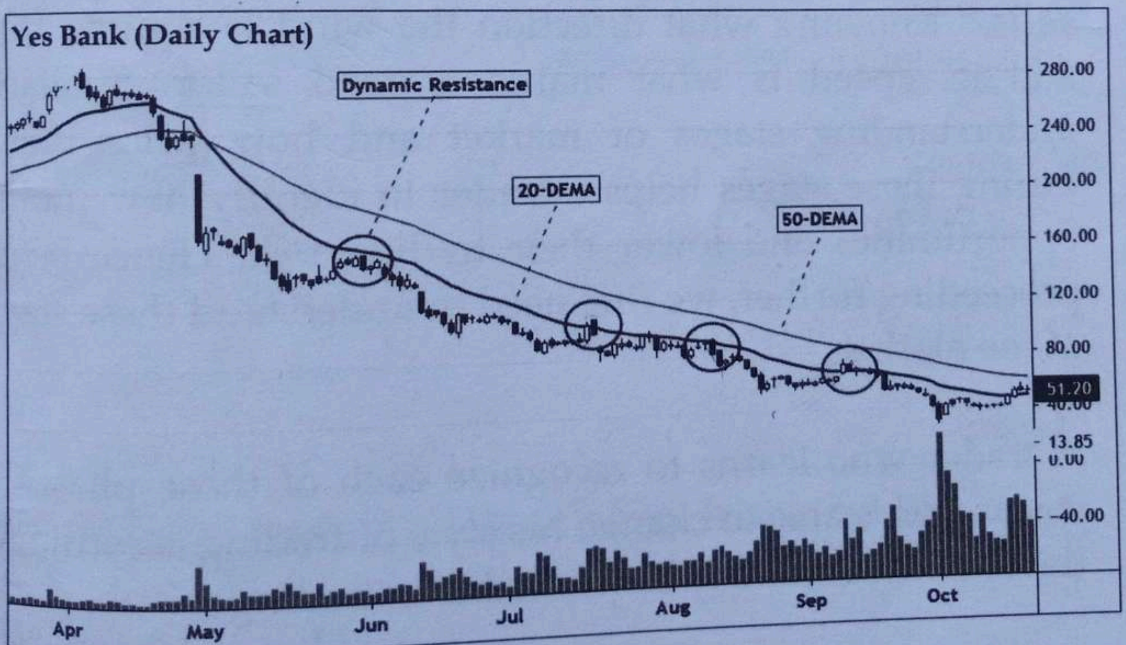


The chart on the previous page is the daily chart of Vaibhav Global from October 2020 to March 2021 and shows how the stock takes support at 20 EMA several times during this period.

When any security is in a downtrend, you will notice that the price of that security is always below the moving average. It occasionally moves up to the moving average line, faces resistance and starts falling again.

Example : Moving Average as Resistance in Downtrend

The chart below is the daily chart of Yes Bank from March 2019 to November 2019. It shows how stock faces resistance at 20 EMA several times during this period.



Many of you might be wondering that why I have used two different moving averages on the chart. It is because 20 EMA will show us the momentum and 50 EMA will depict how healthy the trend is.

I have explained the concept of moving averages and how to use them for trading in detail ahead in the book.

STAGES OF THE MARKET (MARKET CYCLE)

The term **Market Cycle** refers to the period between the two latest highs or lows in case of any security (stock, bonds, commodity, currency, etc). In simple words, it refers to the phases in which the price of any security moves.

Although, prices of securities repeatedly go up and down, market participants who trade in them are interested in knowing the patterns through which prices normally move. These price patterns are known as **Stages of the Market**.

प्रसिद्ध

There is a well known saying which can be applied to trading, ***"We cannot direct the wind, but we can adjust the sails."*** Knowing what direction the wind is coming from and its speed is what makes a good sailor. Similarly, understanding stages of market and how price moves during these stages helps a trader to identify new trading opportunities and lower their trading risk. Hence before proceeding further, we first need to understand these stages of the market.

A trader who learns to recognize each of these phases or stages and is able to change his style of trading accordingly, then he will definitely be profitable in trading.

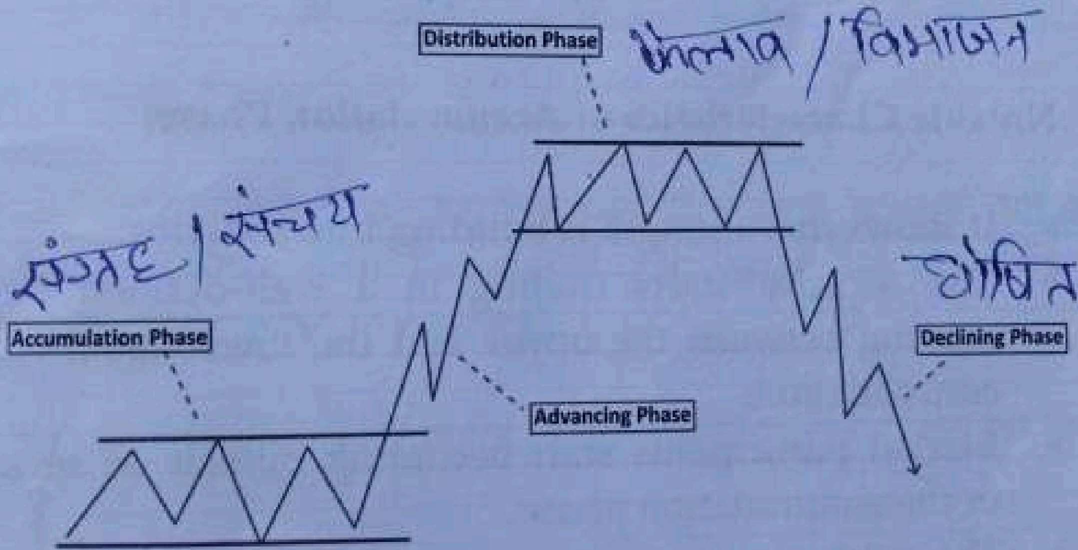
It has been observed in the market that traders usually behave in a certain way at certain times and those behaviors can be captured through important stages of the market. Hence by studying the structure of the market, one comes to know in which way the majority of the market participants are trading in securities.

Main Stages of a Market Cycle :

Market cycles go through four main stages, namely -

- Accumulation Phase
- Advancing Phase
- Distribution Phase
- Declining Phase

These four stages of the market cycle are explained in the pictorial representation drawn below. These stages can be applied to the overall market, an index or any security.



Now I shall explain all these stages in detail.

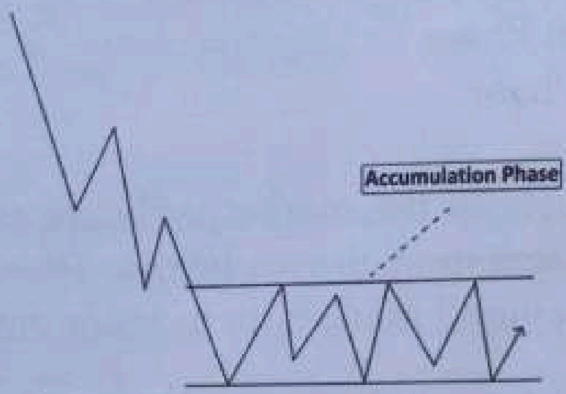
Accumulation Phase -

The accumulation stage is the first stage of every market cycle. This stage occurs when the security goes into a consolidation phase after completion of the declining phase of the previous cycle. During this stage, people start accumulating security when it is trading in a bounded range.

This phase is also known as the 'basing' period because it comes after a downward trend but before an uptrend.

प्रमुख

A prominent feature of this phase is an increase in the volume of trading but not in its price.

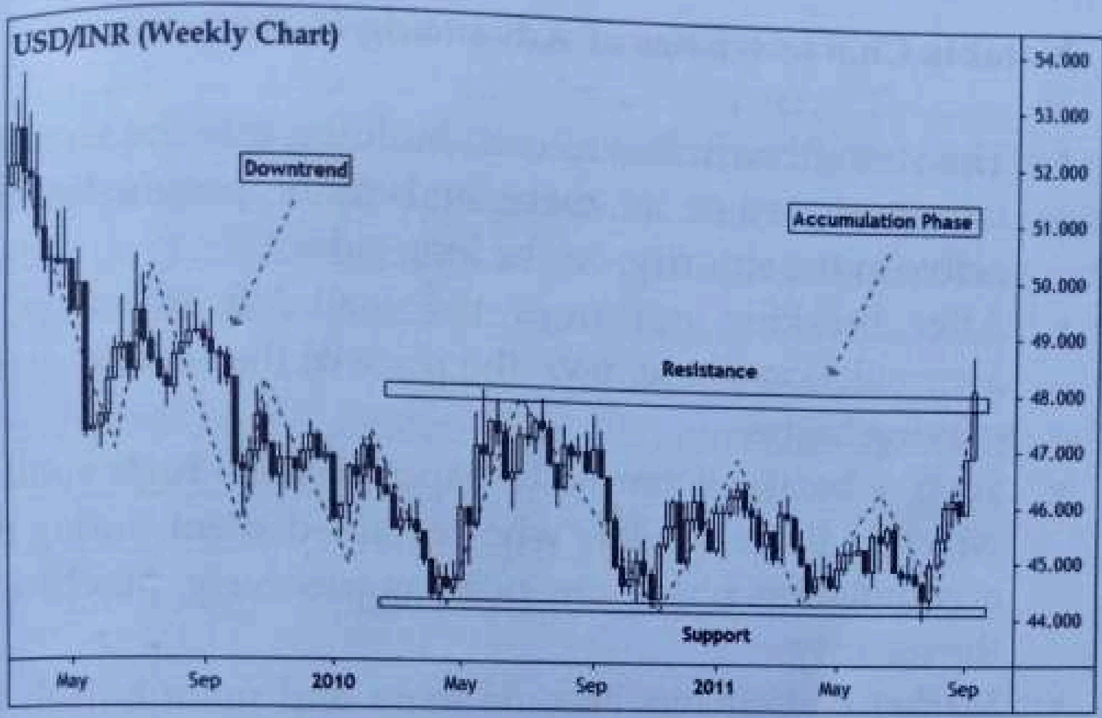


Notable Characteristics of Accumulation Phase:

- It shows that strength is building into security.
- The security starts trading in a well-defined range, moving between the upper and the lower band of the consolidation.
- Market participants start becoming bullish on security in the accumulation phase.
- The price starts moving in a range indicating that the price of the security is bottoming out.
- This phase indicates that a fight is happening between buyers and sellers and eventually, buyers take over sellers towards the end of this phase.

Example : Accumulation Phase

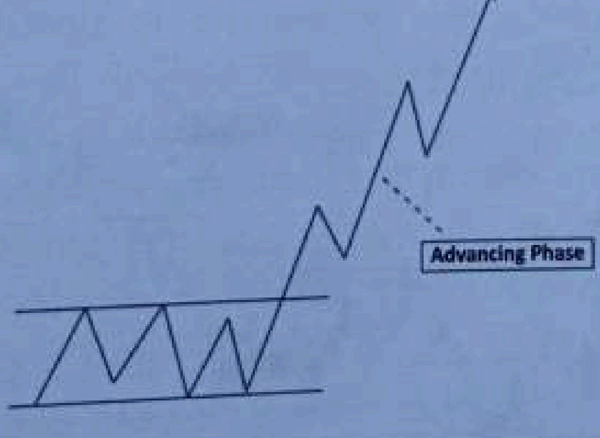
The image on the next page shows the weekly chart of USD/INR currency pair from March 2009 to September 2011 showing an example of the accumulation phase.



Advancing Phase -

Once the security has broken out from the accumulation stage it enters into the advancing stage which shows continued strength in uptrend.

It also shows that now most of the people are bullish on the security.

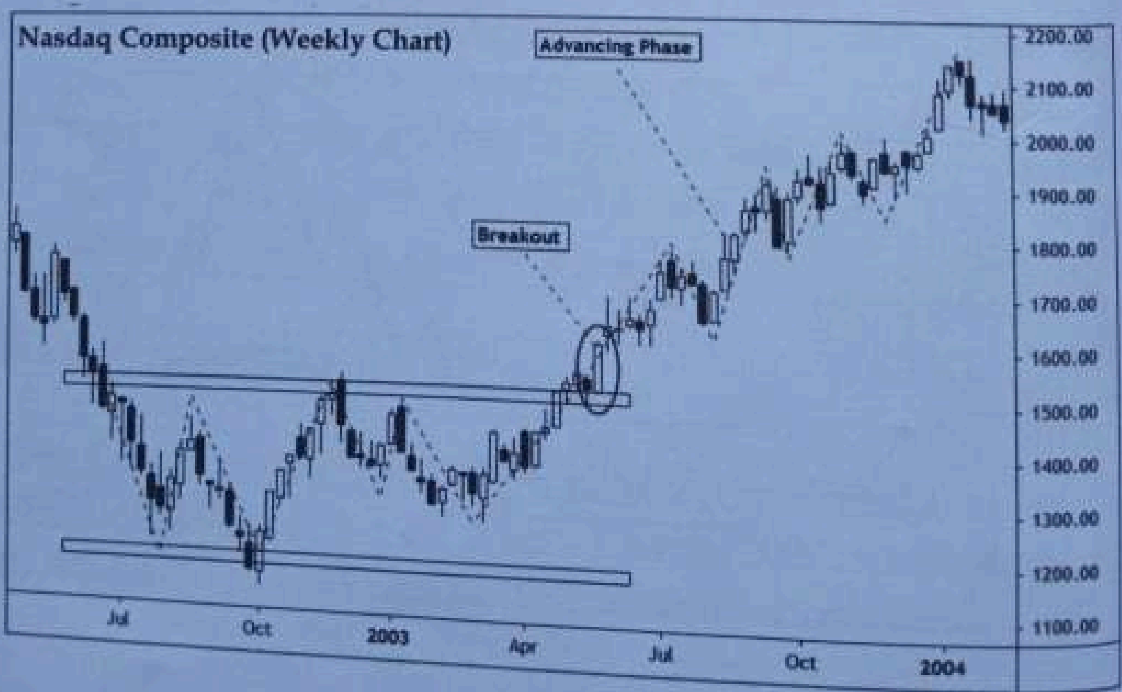


Notable Characteristics of Advancing Phase:

- The strength which was seen building into the security, increases further as more and more people become active in the security, on the long side.
- After breaking out from the well-defined range of accumulation phase, now the price of the security starts moving higher.
- Such a breakout normally happens with high volume which indicates traders who remained silent during the accumulation phase are now aggressively purchasing the security.
- Market participants become more and more bullish on the security during this phase.
- The price of the security starts making higher highs and higher lows during this phase.

Example : Advancing Phase

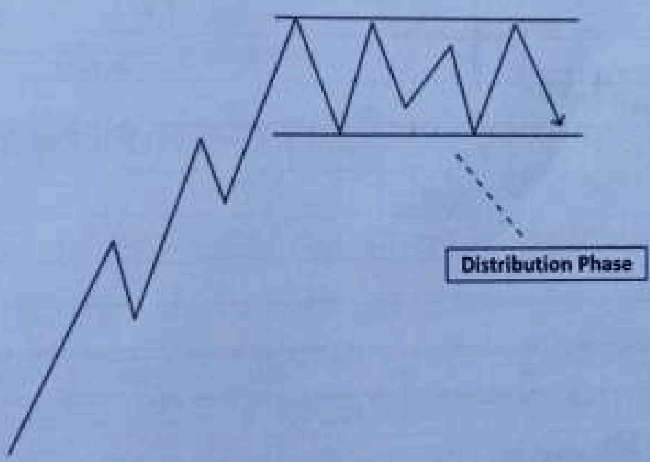
The image below shows the weekly chart of Nasdaq Composite Index from April 2002 to February 2004 showing an example of the advancing phase.



Distribution Phase -

During this phase the security starts losing its momentum and people starts booking profits which ultimately shows that buyers are exiting and some traders are also seen making short position in the security.

Just like the accumulation phase, during this phase as well the security can be seen trading in a bounded range.

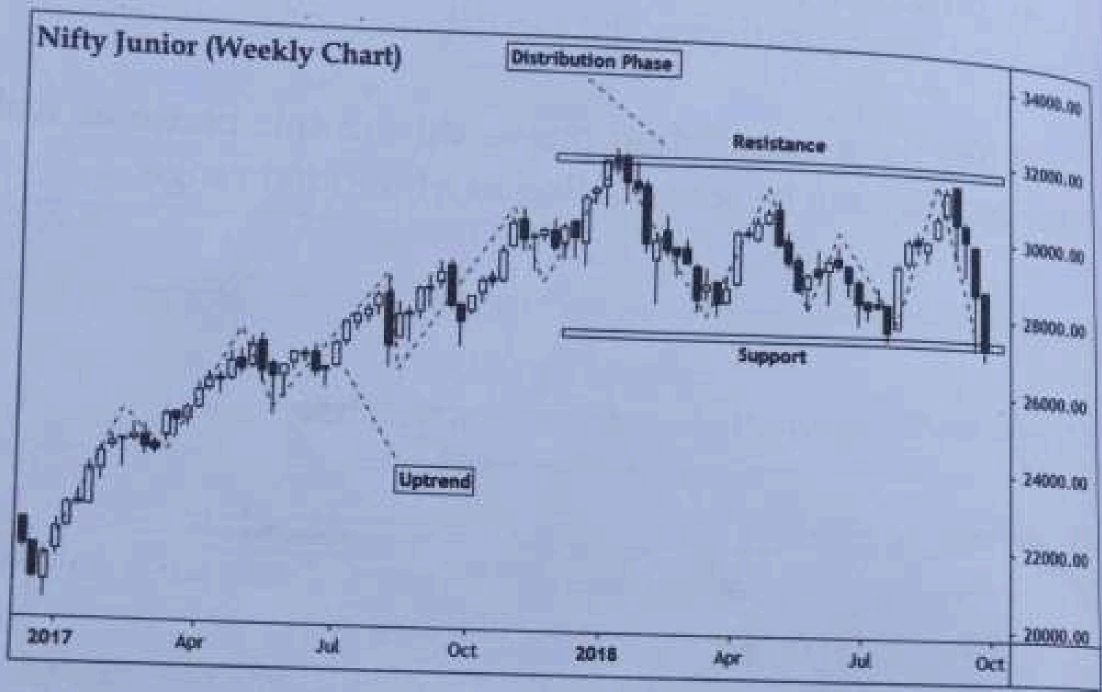


Notable Characteristics of Distribution Phase :

- The strength which was earlier strong now starts weakening as people start becoming cautious.
- After completion of advancing stage, security starts trading in a well-defined range, moving between upper and lower band of the consolidation.
- Market participants start booking profits and some are even seen making short positions in the security.
- The price starts moving in a range indicating that price of the security is topping out.
- This phase indicates that a fight is happening between buyers and sellers and eventually, sellers take over buyers towards the end of this phase.

Example : Distribution Phase

The image below shows the weekly chart of Nifty Next 50 from December 2016 to October 2018 showing an example of the distribution phase.



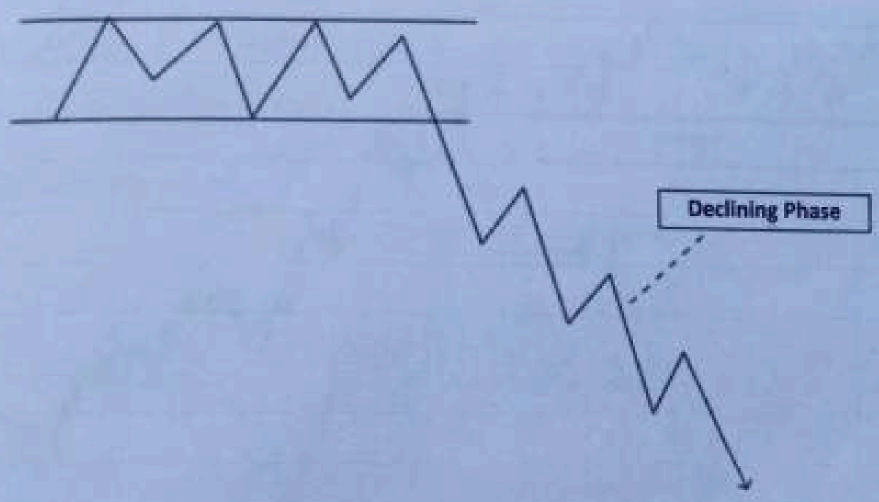
Declining Phase -

Once the security has broken out from the distribution stage it enters into the declining stage which shows continued strength in the downtrend. It shows that now most of the people are bearish on the security.

This is the last stage of the market cycle and is not a favorable time for most of the investors.

This phase is also known as the reversal phase because during this phase traders who had earlier purchased the security during the accumulation phase begin to exit.

A prominent feature of this phase is an increase in the volume of trading along with a sharp decline in the price.

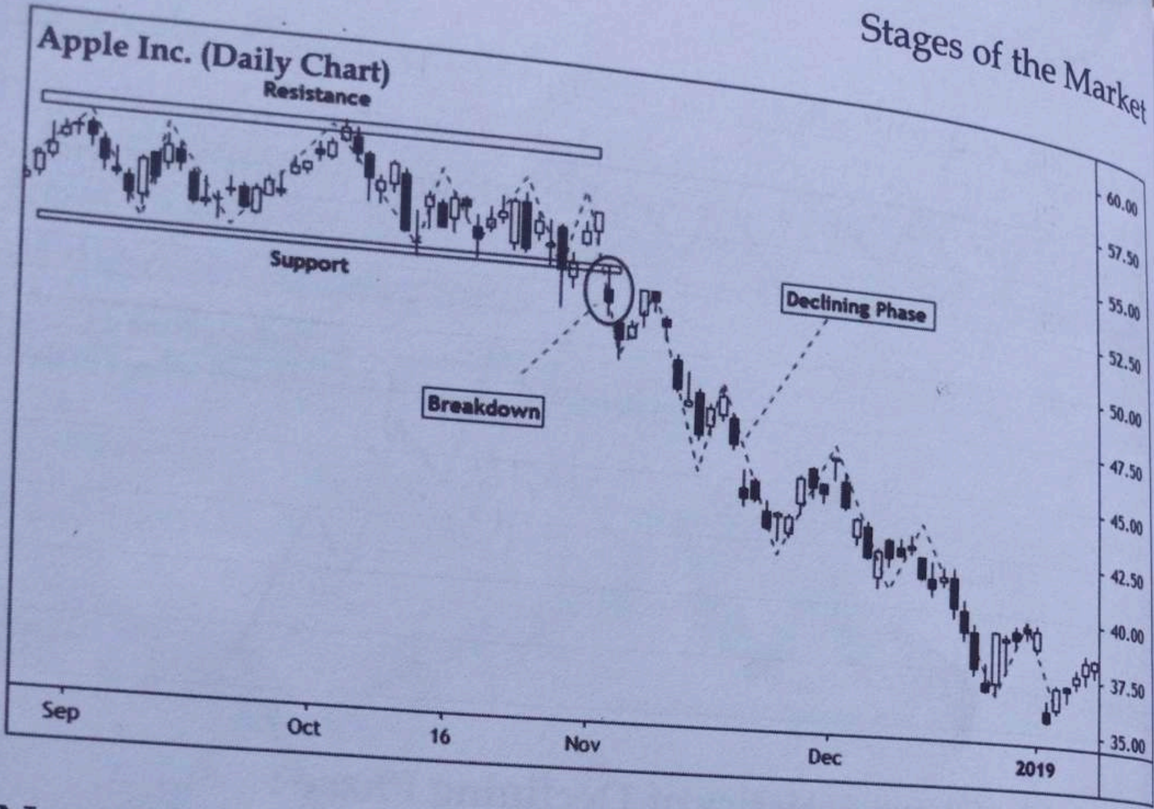


Notable Characteristics of Declining Phase :

- The weakness which was seen building into the security, increases further as more and more people become active in the security on the short side.
- After breaking down from the well-defined range of distribution phase, now the price of the security starts declining.
- Such a breakdown normally happens with high volume which indicates traders who remained silent during the distribution phase are now aggressively selling the security.
- Market participants become more and more bearish on the security during this phase.
- The price of the security starts making lower lows and lower highs during this phase.

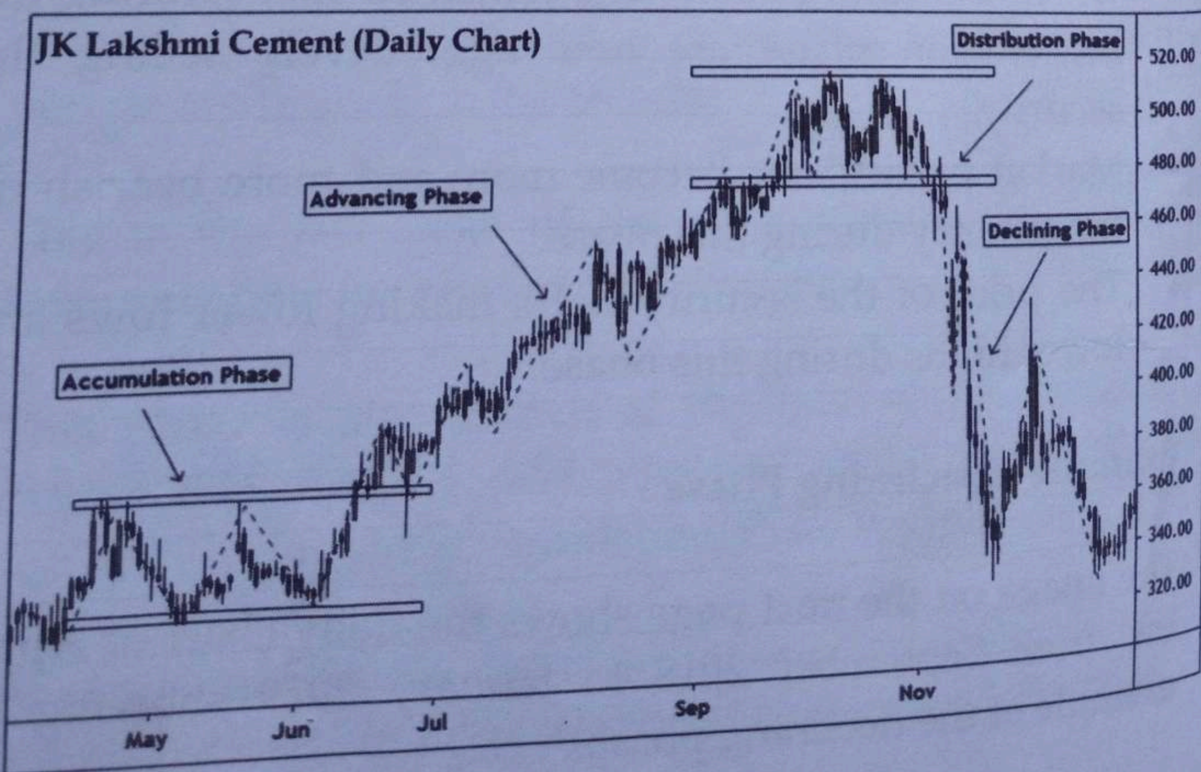
Example : Declining Phase

The image on the next page shows the daily chart of Apple Inc. from September 2018 to January 2019 showing an example of the declining phase.

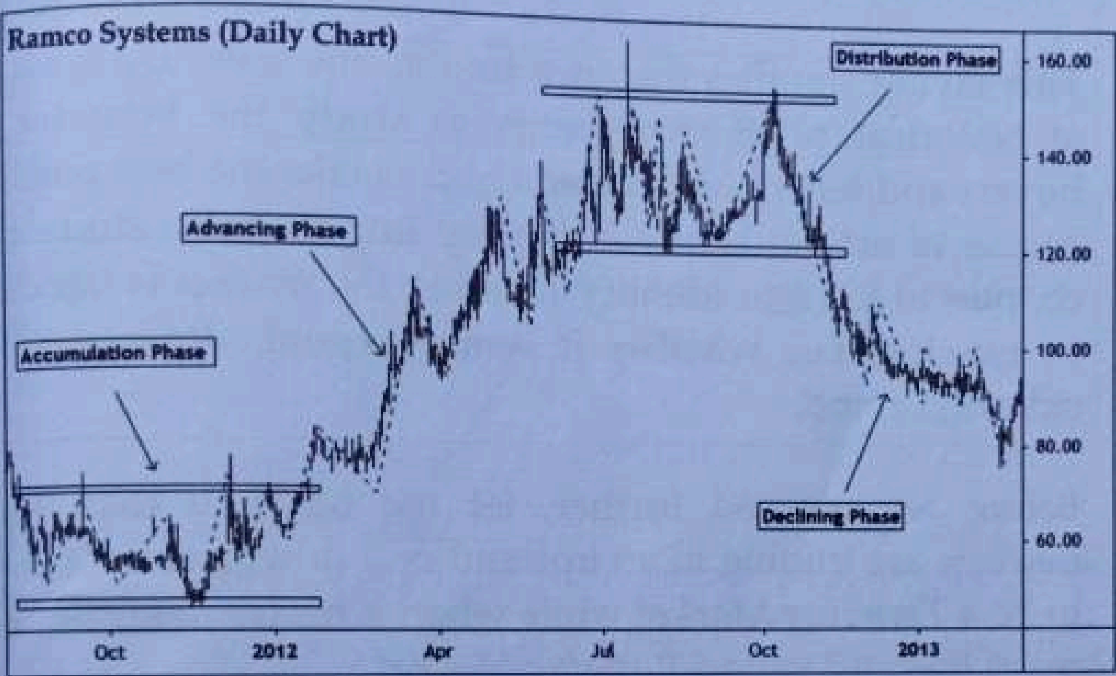


Now that you have understood all these phases of a market cycle, you should try to train your eyes to spot all these phases of the market cycle on charts.

The image below shows the daily chart of JK Lakshmi Cement from April 2016 to December 2016. During this period you can clearly see all the four market stages i.e., Accumulation, Advancing, Distribution and Decline.



The image below shows daily chart of Ramco System from October 2011 to December 2013. In this chart also you can clearly see all the four market stages which we have discussed in this chapter.



TRENDING AND RANGING MARKET

When we talk about trading, there is a well known saying, ***"Trend is Your Friend."***

This saying signifies that as a trader, one must always look at historical price movements to study the behavior of buyers and sellers which leads him to take the best possible course of action. Hence it is very important to study this chapter to learn to identify whether the market is trending or ranging, i.e., whether it is in uptrend, downtrend or sideways trend.

Before we proceed further, let me tell you that when markets are trading in an uptrend or a downtrend it is said to be a ***Trending Market*** while when it trades in a sideways trend it is said to be a ***Ranging Market***.

What is Trending Market?

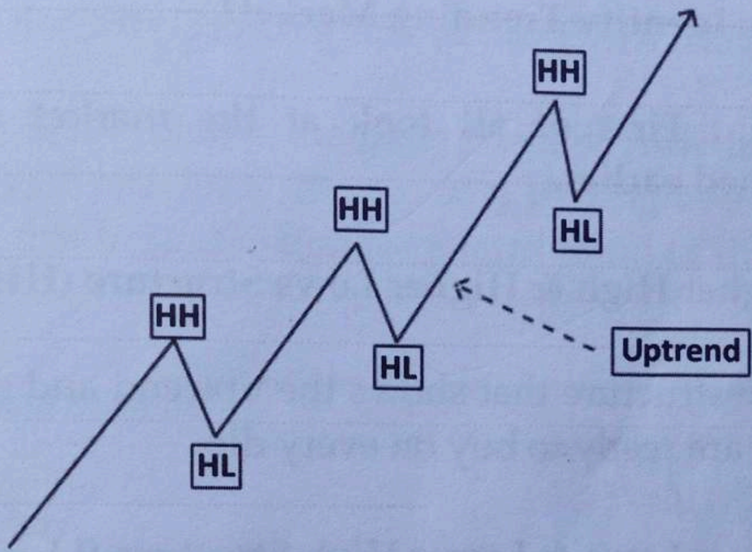
A trending market is generally when you see prices moving in one direction (either up or down).

A trending market will have small correction or pullbacks (retracements) but when you look at the larger picture (longer time frame) you will see the market going in a defined direction.

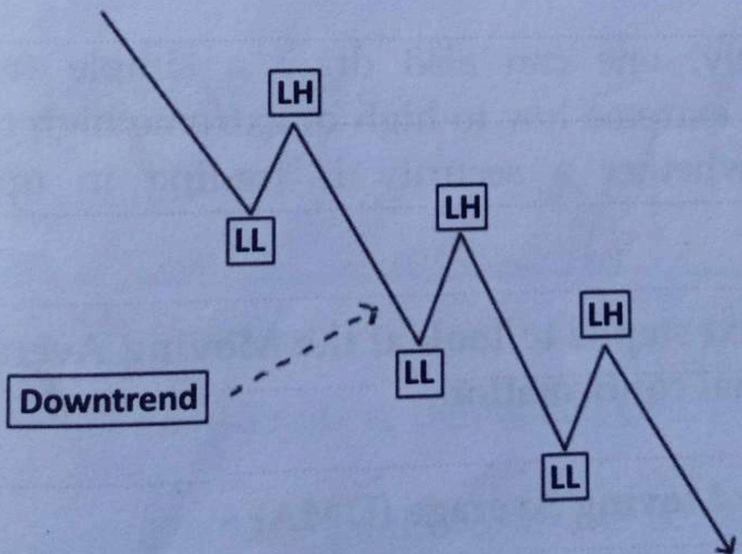
There is no specific time frame to identify a trending market, you can use any time frame like Daily, Weekly, Monthly depending on your trading type and style (i.e., scalping, intraday trading, swing trading, positional trading, short term trading, long term investing, etc). However, always keep in mind, ***the higher the time frame you use, the better the trend will look.***

Trending markets are easier to spot.

The market is said to be trending in an upward trend when the price of a security makes a series of Higher Highs and Higher Lows (HH&HL Structure).



Similarly, the market is said to be trending in a downward trend when the price of a security makes a series of Lower Lows and Lowers Highs (LL&LH Structure).



Trending Market usually shows that market participants have become either bullish (up trending) or bearish (down trending) which can be identified easily looking at the chart.

One should always remember that market will be in clear trend 30% of the time and will go range bound 70% of the time, therefore it is very important for us to know when the market is trending and when it is ranging.

How to Identify Trending Market?

Step 1 : First of all look at the market structure as explained earlier.

- **Higher High & Higher Lows Structure (HH&HL) -**

It is the structure that shows the uptrend and suggests that people are ready to buy on every dip.

- **Lower Lows & Lower High Structure (LL&LH) -**

It is the structure that shows the downtrend and suggests that people are ready to sell on every rise.

Alternatively, one can also draw a simple trend line, connecting extreme low to high or extreme high to lows to find out whether a security is trading in uptrend or downtrend.

Step 2 : Next step is to look at the Moving Average to get an additional confirmation.

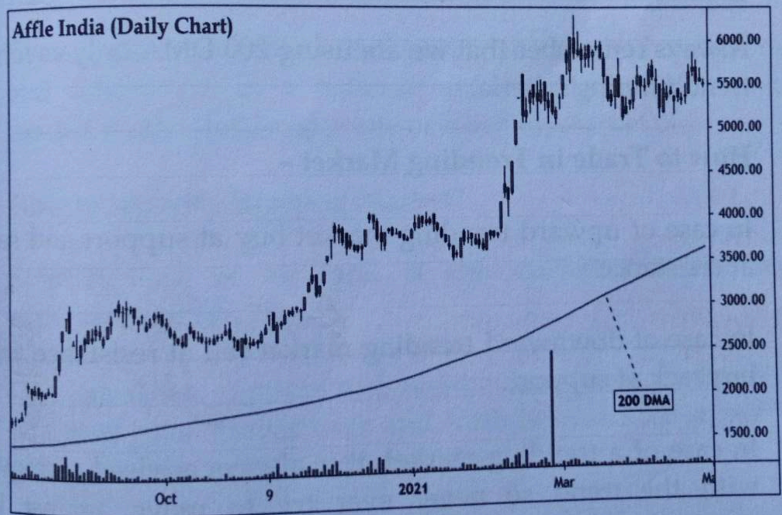
- **200 Day Moving Average (DMA) -**

After looking at the market structure, the next step is to look at the 200 DMA.

If the security is trading above the 200 DMA then it is said to be bullish i.e., trading in an uptrend. Similarly, if the security is trading below the 200 DMA then it is said to be bearish i.e., trading in a downtrend.

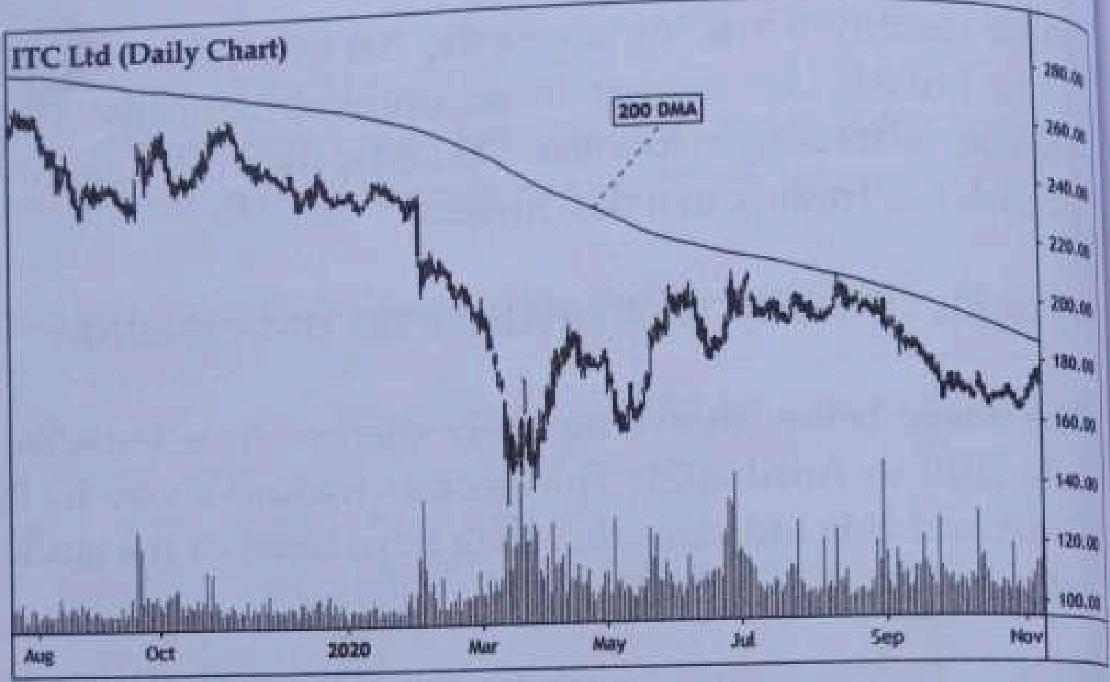
Example : Security Trading Above 200 DMA (Bullish)

The image below shows the daily chart of Affle India from July 2020 to April 2021. The stock is trading above its 200 DMA and this indicates that long term trend of the stock is bullish.



Example : Security Trading Below 200 DMA (Bearish)

The image on the next page shows the daily chart of ITC Ltd from August 2019 to October 2020. The stock is trading below its 200 DMA and this indicates that long term trend of the stock is bearish.



Always remember that we are using 200 DMA only as long trend filtering criteria.

How to Trade in Trending Market –

In case of upward trending market buy at support and sell at resistance.

In case of downward trending market sell at resistance and buyback at support.

In case of a trending market, it is always advised to move with the trend so never ever try to move against it, especially when you are new.

So never do this –

Never sell at resistance to buyback at support in case of upward trending market.

Never buy at support and sell at resistance in case of downward trending market.

What is Ranging Market?

A Ranging market is a situation when price consolidates within a range. During such a market condition we see price moving back and forth between support and resistance level, a number of times. It is also referred to as consolidation, congestion phase, range bound, choppy, sideways or flat market.

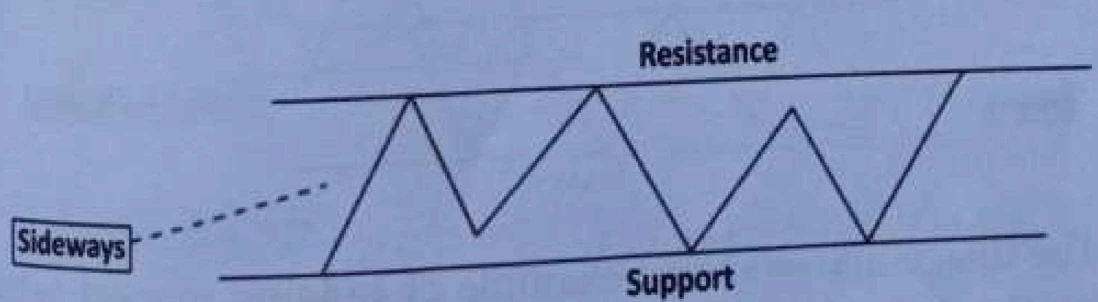
The resistance prevents the price to increase any further and support prevents the prices to fall any further. Hence the price of the security moves in a range bound phase.

The significance behind the ranging market is that buyers and sellers are in a balance and equilibrium. Ranging market is completely opposite of trending market.

How to Identify Ranging Market?

Step 1: First of all look at the market structure as explained earlier.

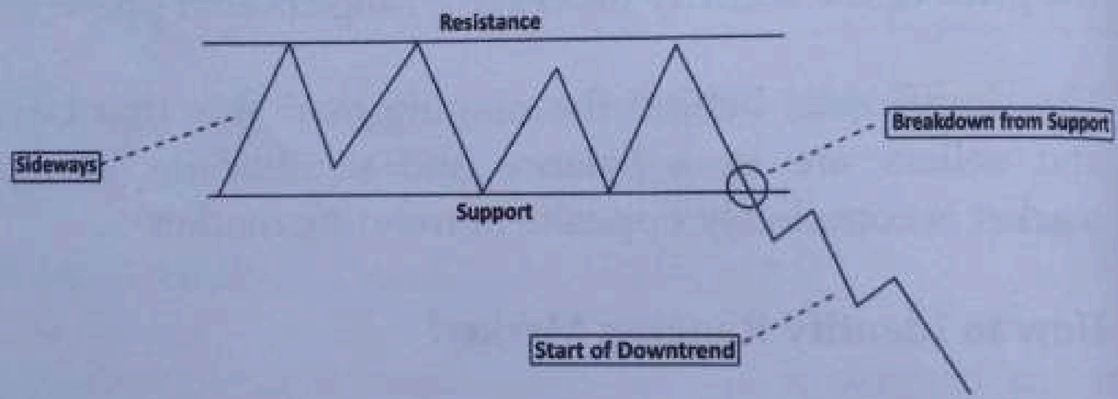
One can draw support and resistance lines or zones and find that price moves back and forth between the support and resistance level, a number of times.



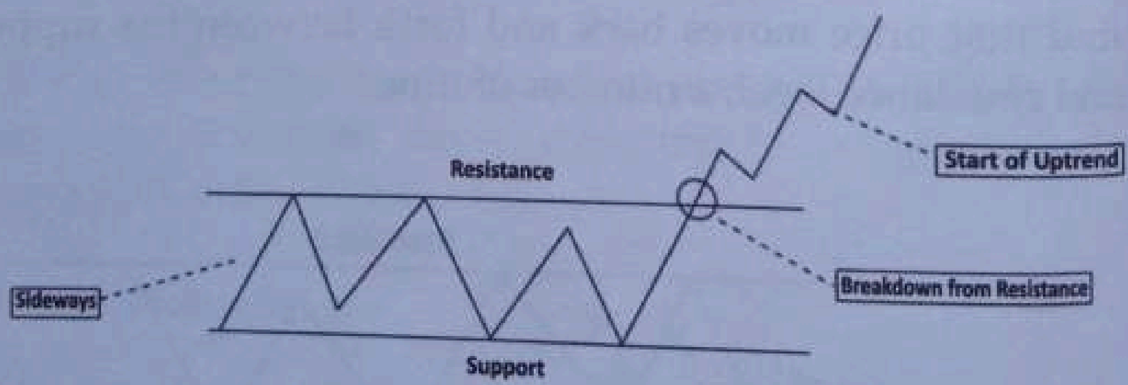
Step 2: Next step is to look at the volume to get an additional confirmation.

After looking at the market structure, the next step is to look at the volume. The volume dries up when the price of a security goes into consolidation phase as compared to when it was trending up or down.

In ranging market when the price breaks through either support or resistance, it paves way towards downtrend or uptrend respectively.



The image above shows an example of ranging market which breaks through support on lower band of the sideways trend.

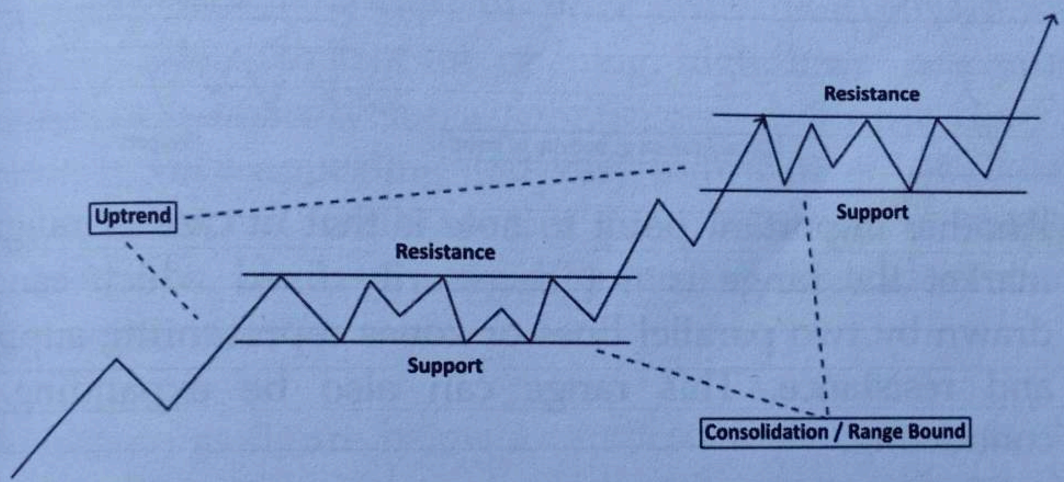


The image above shows example of ranging market which breaks through resistance on higher band of the sideways trend.

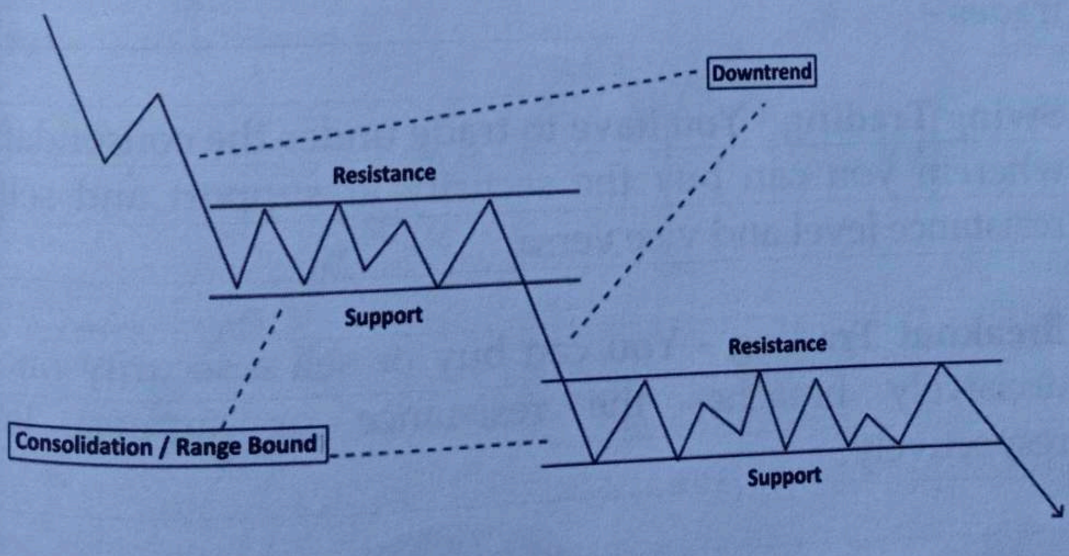
Around 70% of the time, market is ranging this is because market can be in a ranging mode in between a longer term primary uptrend or downtrend or could be ranging before a trend reversal takes place.

I have explained this with the help of a few examples.

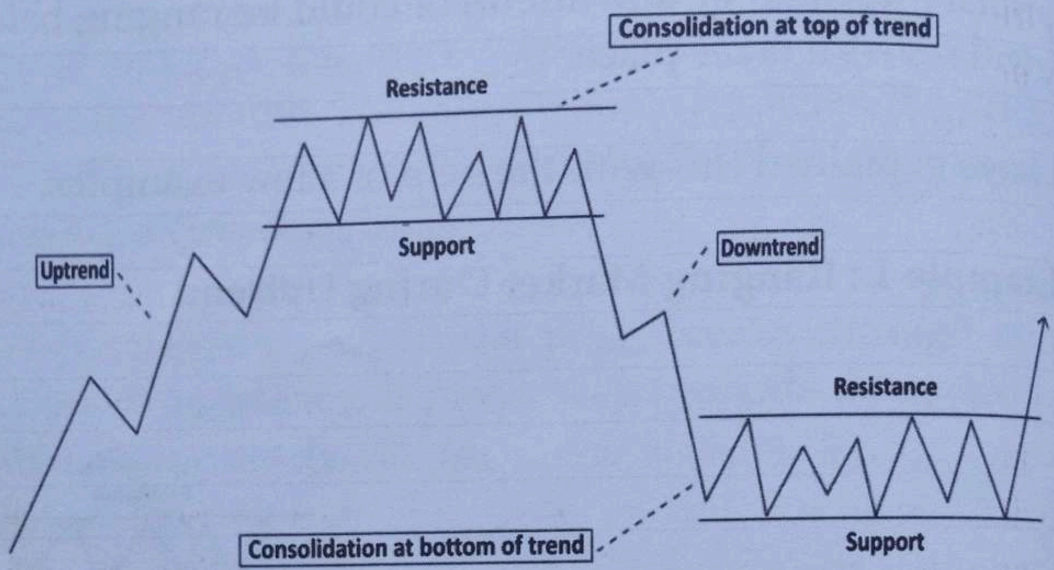
Example 1 : Ranging Market During Uptrend



Example 2 : Ranging Market During Downtrend



Example 3 : Ranging Market at the top of the Uptrend and Downtrend



Another important point to note is that in case of ranging market the range is not necessarily fixed which can be drawn by two parallel lines or zones representing support and resistance. This range can also be expanding or contracting.

How to Trade in Ranging Market –

In case of a ranging market, there are two possibilities of trades –

Swing Trading - You have to trade under the consolidation wherein you can buy the security at support and sell at resistance level and vice versa.

Breakout Trading - You can buy or sell a security once it decisively breaches the resistance or support level, respectively.

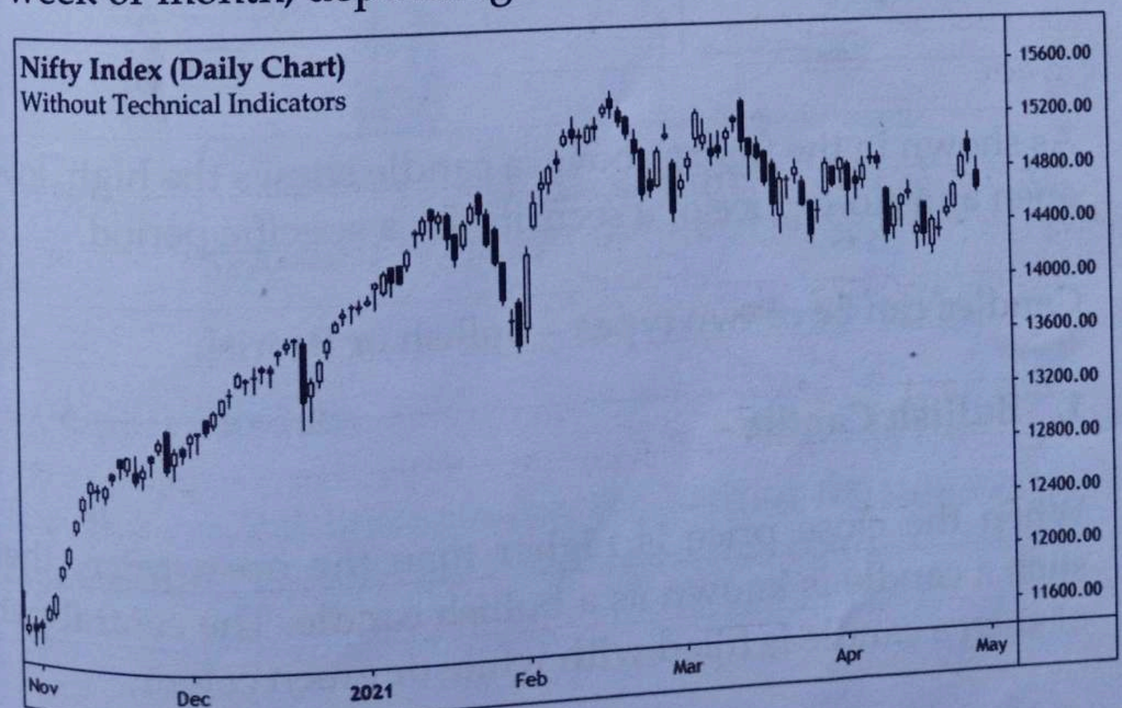
CANDLESTICK PATTERNS

Originally used by 17th century rice traders in Japan, today *Candlestick Charts* are used by traders and investors around the world to trade in securities.

If you are about to start your trading journey then the first thing you need to learn is how to use candlestick charts.

A *candlestick* is a type of price chart used in technical analysis that displays the opening, high, low, and closing prices of a security for a specific period. Such a chart is visually very appealing and very informative. It indicates the current as well as the past behavior of market participants. Hence it is used by most of the traders across the world.

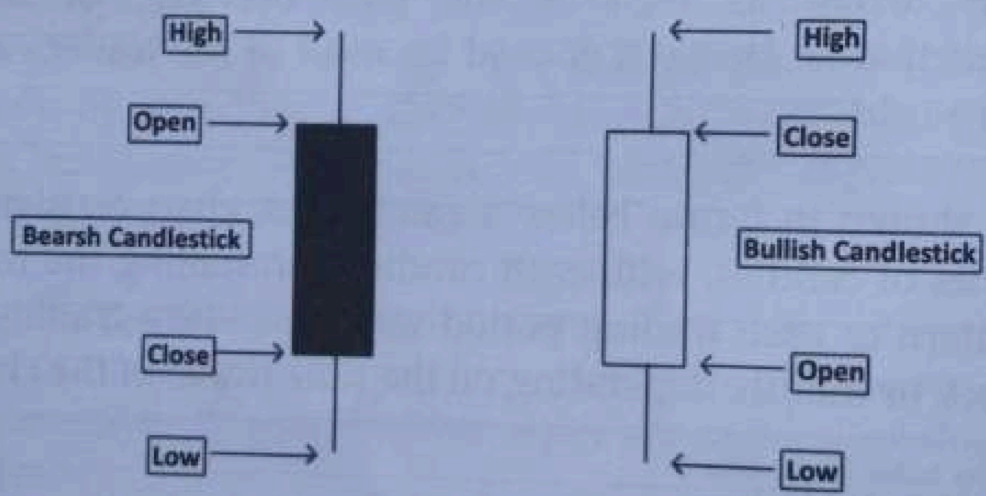
As shown in figure below a candlestick chart consists of a series of candles, with each candle representing the trading pattern of each trading period which can be a trading day, week or month, depending on the time frame of the chart.



Patterns formed by a single candle or grouping of two or more candles in a certain sequence are known as *Candlestick Patterns*. Such patterns help a trader to study the past and current price movement of the security to spot trend reversals or trend continuations and hence traders use these candlesticks patterns to identify trading opportunities.

Candlestick Patterns reflect what buyers and sellers are doing and hence it is important to study them.

Before we proceed further, first let us understand the basic candle formation.



As shown in the figure above, a candle shows the high, low, open and close price of a security for a specific period.

Candles can be of two types – Bullish or Bearish.

1. Bullish Candle –

When the close price is higher than the open price, then such a candle is known as a bullish candle. The central part of such a candle is filled with white or green colour.

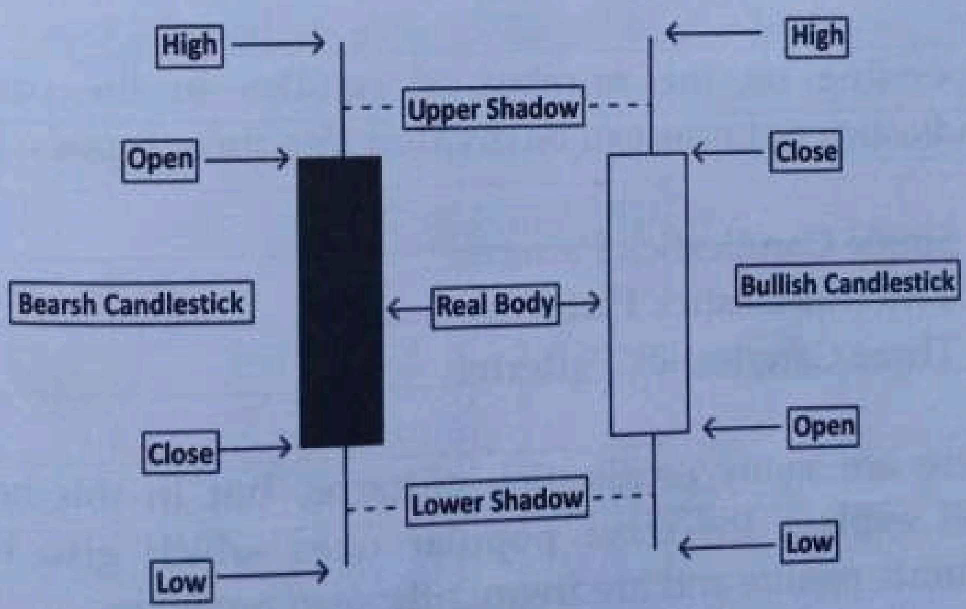
Such a candle signifies positive sentiment and indicates that the price of the security is likely to increase further.

2. **Bearish Candle -**

When the close price is lower than the open price, then such a candle is known as a bearish candle. The central part of such a candle is filled with black or red colour.

Such a candle signifies negative sentiment and indicates that the price of the security is likely to decrease further.

As shown in the figure below, a candle has three parts - upper shadow, real body and lower shadow.



- **Upper Shadow -**

It is the vertical line between the high of the day and the close (for Bullish Candle) or the open (for Bearish Candle).

- **Body -**

It is the wide part of a candle, showing the difference between the open and closing price. If the open is below the close, then it is a bullish candle whose real body is filled with white or green colour and if the close is below the open, then it is a bearish candle whose real body in this case is filled with black or red colour.

- **Lower Shadow -**

It is the vertical line between the low of the day and the open (for Bullish Candle) or the close (for Bearish Candle).

Types of Candlestick Patterns :

Depending on the number of candles in the patterns, candlestick patterns can be divided into three types -

1. Single Candlestick Patterns
2. Two Candlestick Patterns
3. Three Candlestick Patterns

There are many candlestick patterns, but in this book, I shall explain the most popular ones which give highly accurate results and are frequently seen on charts.

Single Candlestick Patterns -

As the name indicates, such patterns are formed by a single candle.

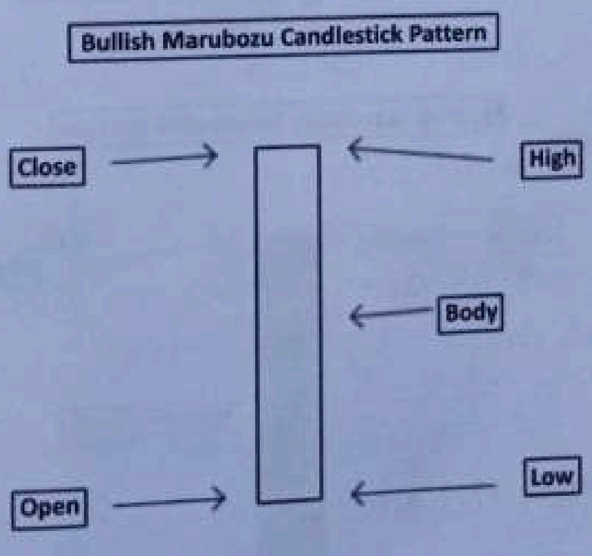
Popular Single Candlesticks Patterns include -

- Bullish Marubozu
- Bearish Marubozu
- Hammer
- Hanging Man
- Inverted Hammer
- Shooting Star
- Doji

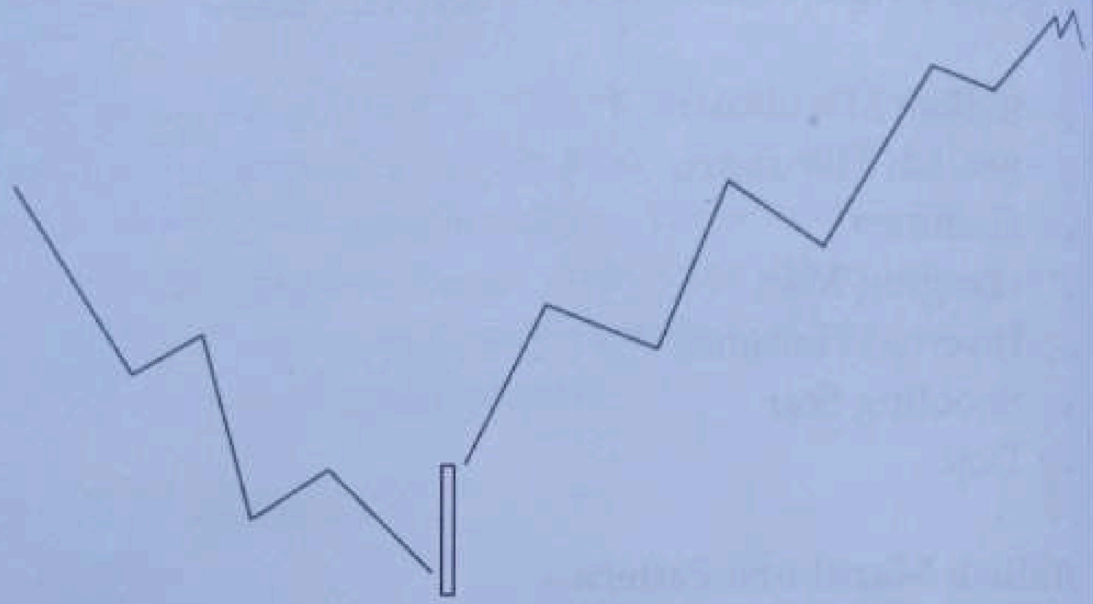
Bullish Marubozu Pattern -

Bullish Marubozu is a single candlestick pattern that is used in technical analysis to predict bullishness.

The word Marubozu means "Bald" in the Japanese. Bullish Marubozu is basically a long green or white bullish candle that has no or negligible shadow (upper and or lower).



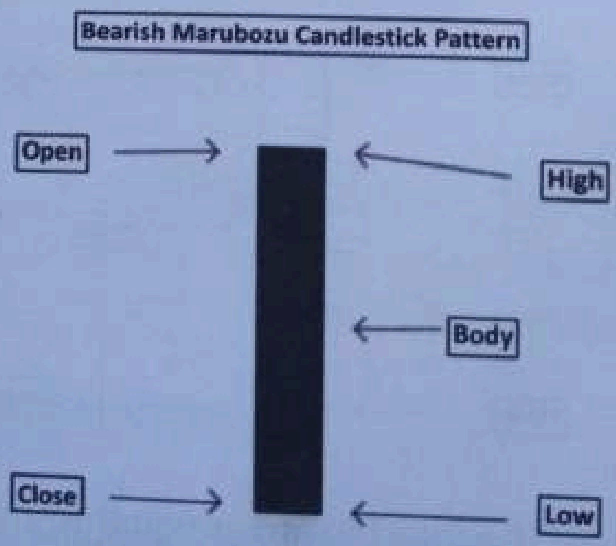
It occurs when the low is almost equal to the open and the high is almost equal to the close. It is considered to be a very strong sign of bullishness.



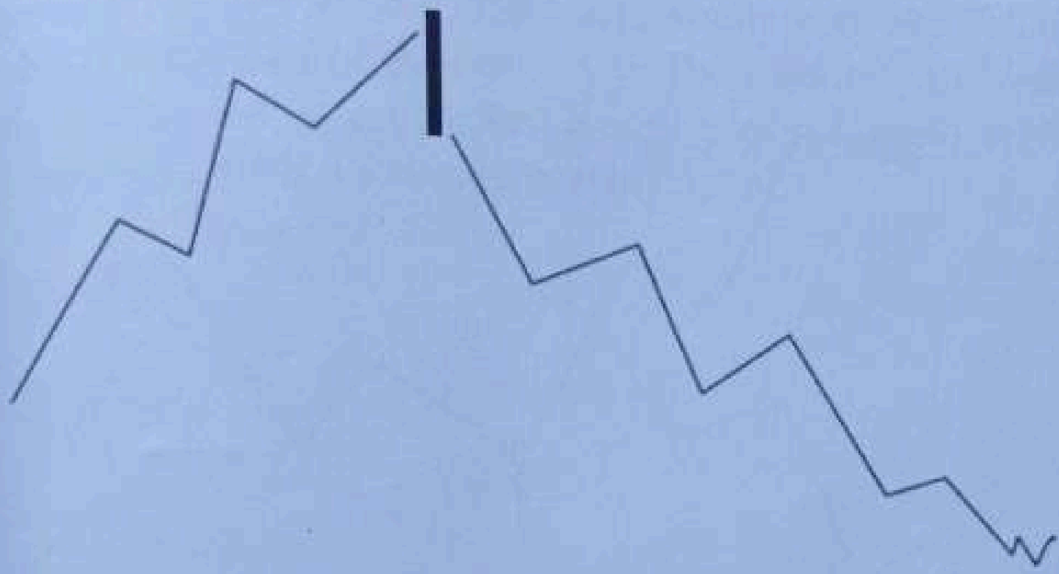
Bearish Marubozu Pattern -

Bearish Marubozu is a single candlestick pattern that is used in technical analysis to predict bearishness.

Bearish Marubozu is basically a long red or black bearish candle that has no or negligible shadow (upper and or lower).

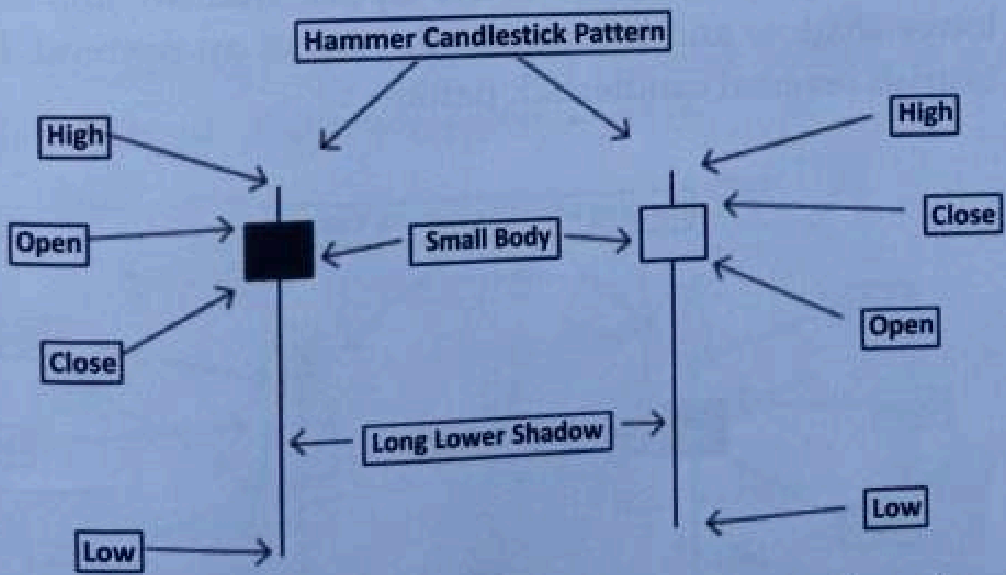


It occurs when the high is almost equal to the open and the low is almost equal to the close. It is considered to be a very strong sign of bearishness.

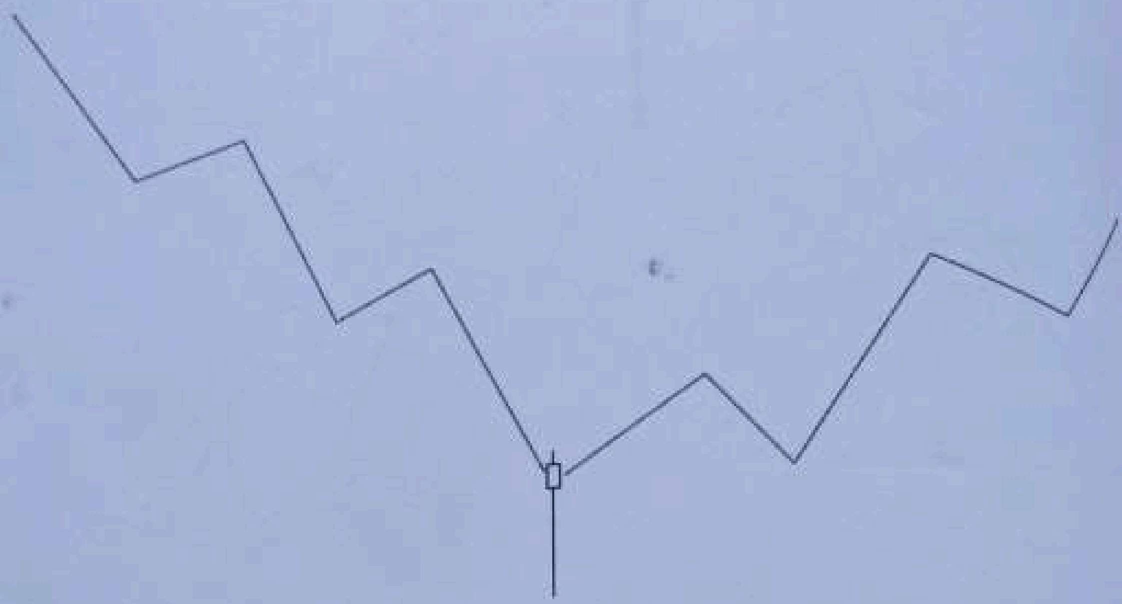


Hammer Pattern –

This candlestick pattern is formed by a candle that has a small body with a little or no upper shadow and a long lower shadow and is found at the bottom of a downtrend. It is a bullish reversal candlestick pattern.



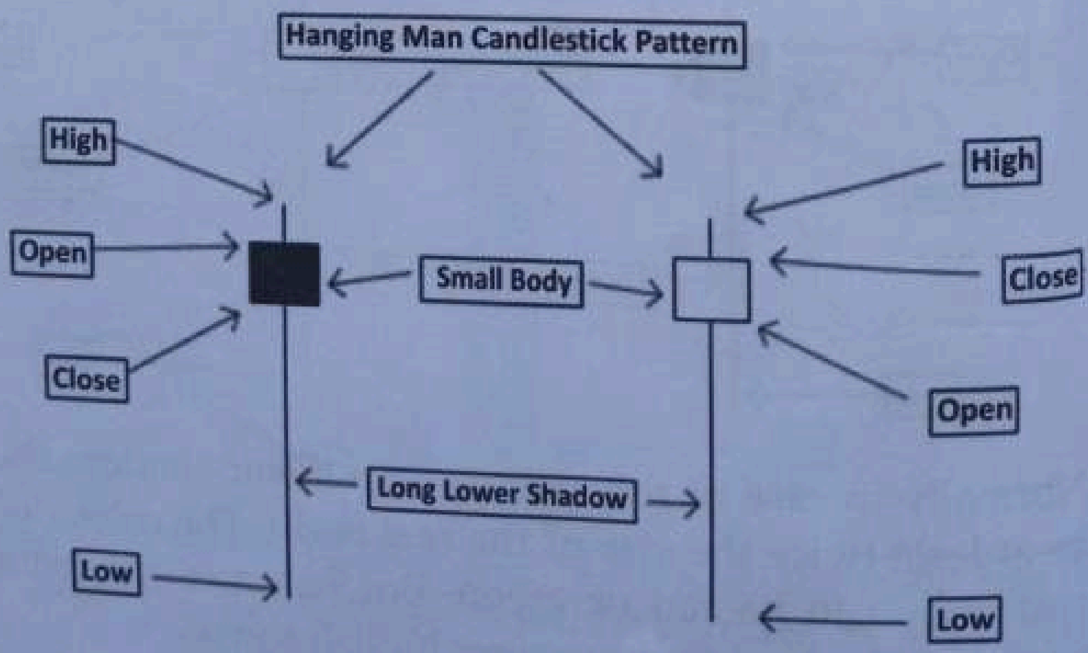
Normally in case of this pattern, the lower shadow should be at least twice the size of the real body. The colour of the real body can be red or green. But hammer formed with green real body gives a stronger bullish signal.



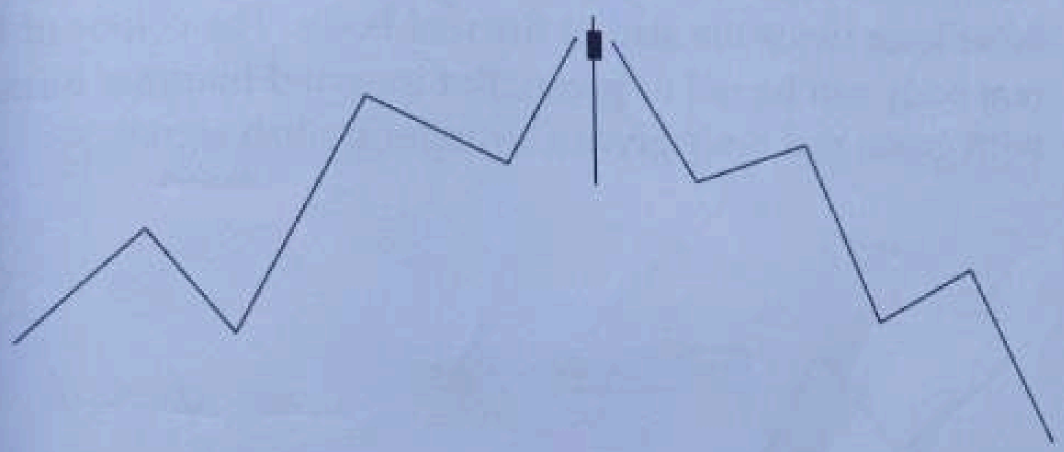
This pattern act as a warning signal for a potential upside reversal.

Hanging Man Pattern –

This candlestick pattern is formed by a candle that has a small body with a little or no upper shadow and a long lower shadow and is found at the top of an uptrend. It is a bearish reversal candlestick pattern.



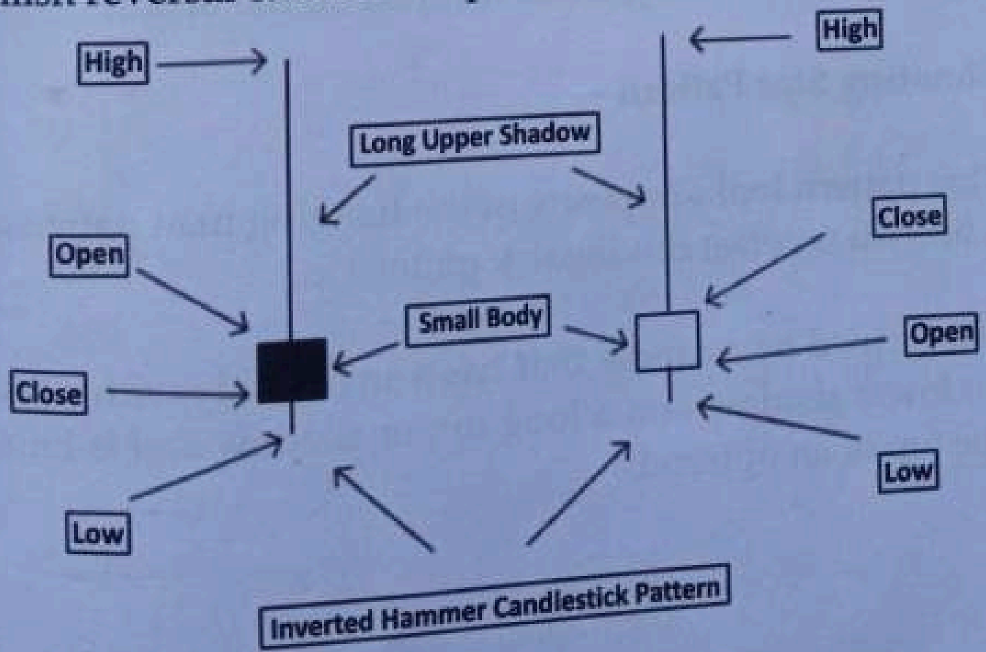
Normally for this pattern, the lower shadow should be at least twice the size of the real body. The colour of the real body can be red or green. But hanging man formed with red real body gives a stronger bearish signal.



This pattern act as a warning signal for a potential downside reversal.

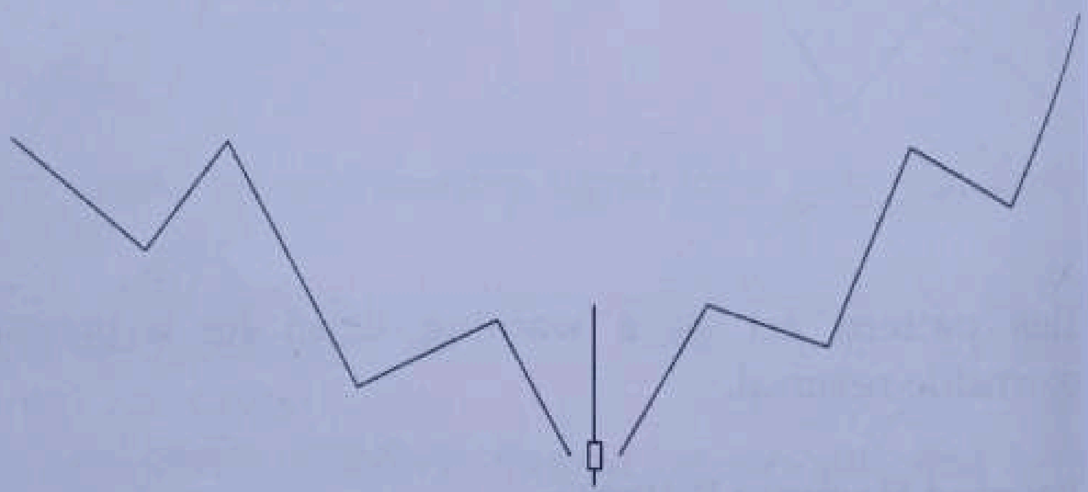
Inverted Hammer Pattern -

This pattern looks opposite of the hammer pattern. It is a bullish reversal candlestick pattern.



It is formed by a candle that has a small body with a little or no lower shadow and a long upper shadow and is found at the bottom of a downtrend.

Normally in case of this pattern, the upper shadow should be at least twice the size of the real body. The colour of the real body can be red or green. But inverted hammer formed with green real body gives a stronger bullish signal.

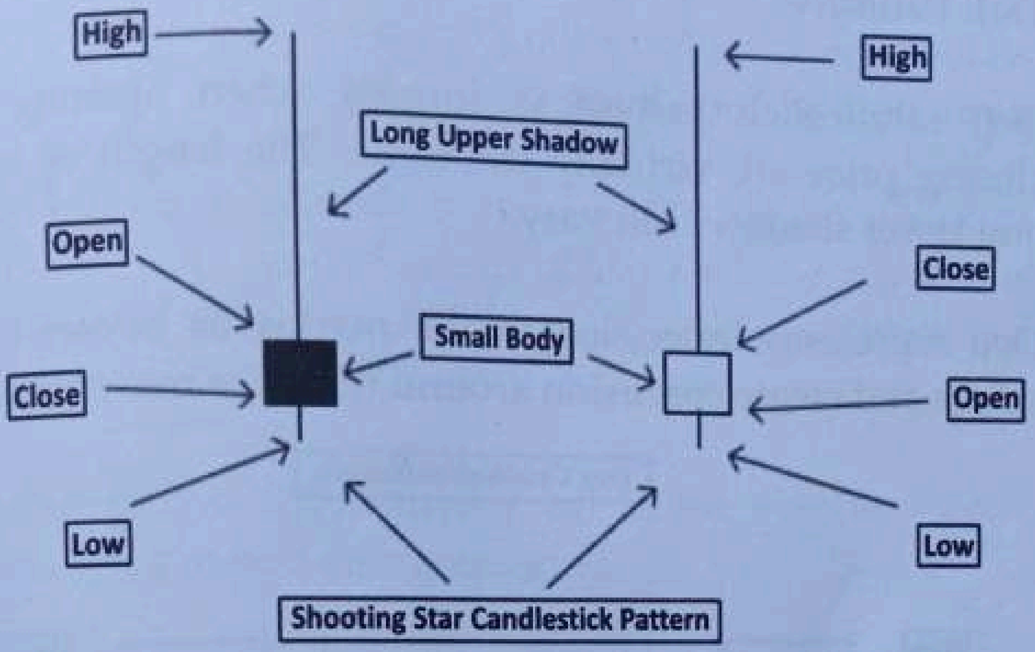


This pattern depicts that buyers are pushing the price higher and indicating trend reversal on the upside.

Shooting Star Pattern –

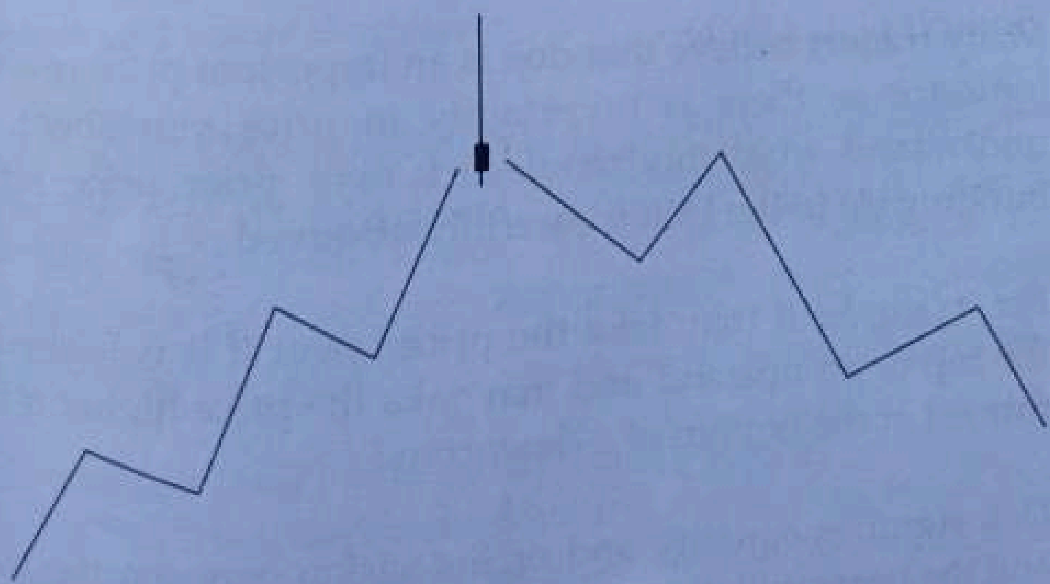
This pattern looks opposite of the hanging man pattern. It is a bearish reversal candlestick pattern.

It is formed by a candle that has a small body with a little or no lower shadow and a long upper shadow and is found at the top of an uptrend.



Normally in case of this pattern, the upper shadow should be at least twice the size of the real body. The colour of the real body can be red or green. But shooting star formed with red real body gives a stronger bearish signal.

This pattern depicts that buyers are losing the ground and sellers are pushing the price lower indicating trend reversal towards the downside.

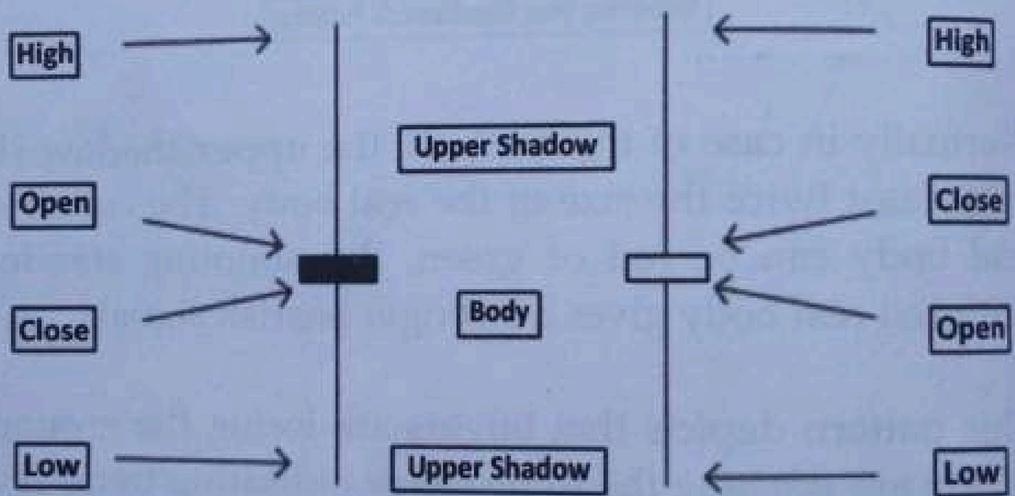


Doji Pattern -

Doji candlestick pattern is formed when opening and closing price are virtually the same. The length of upper and lower shadows can vary.

Doji represents indecision in the market as buyers equal sellers and create confusion around the price movement.

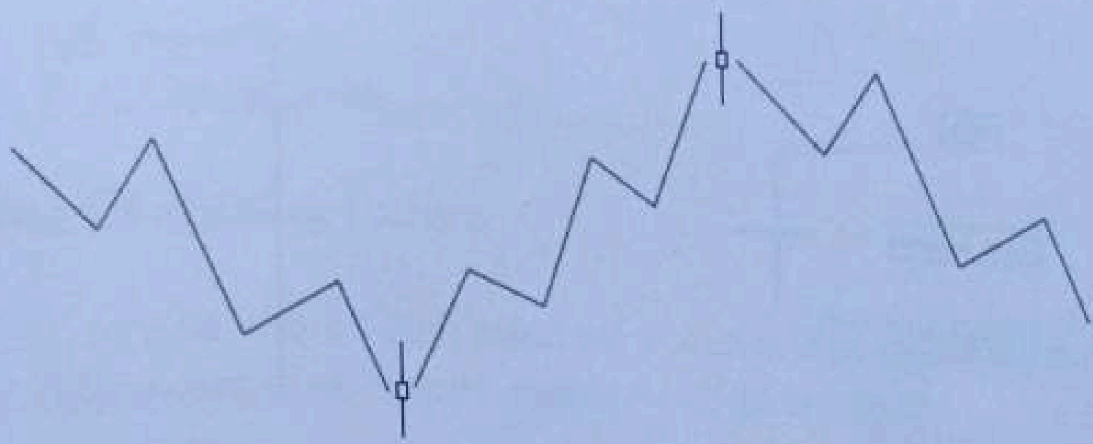
Doji Candlestick Pattern



Many traders believe that doji is an important price reversal indicator as there is uncertainty in price movement. To understand what this candlestick says, prior price action building up to the Doji is carefully observed.

For example, it may take the price lower if it is formed at the top of an uptrend and may take the price higher if it is formed at the bottom of a downtrend.

Doji signifies equality and or indecision between the bulls and the bears which is a warning sign of reversal.



If Doji is coupled with dry up in the volume then it is considered to be a stronger signal.

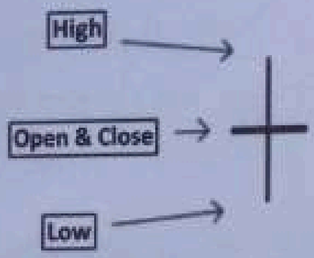
Depending on the length of the shadows, doji patterns are of 4 type's - standard doji, long legged doji, dragonfly doji and gravestone doji.

Standard Doji - It is the very basic doji candlestick pattern that might appear at the top or the bottom of the trend indicating trend reversal. Its shape is similar to 'cross' or 'plus sign'.

Long Legged Doji - This candlestick pattern has long upper and lower shadow.

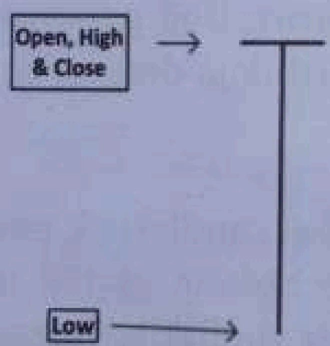
Dragonfly Doji - This candlestick pattern has long lower shadow and no or very small upper shadow. Its shape is similar to English Letter 'T'. It is a bullish reversal candlestick pattern that indicates that the price of an asset is likely to go up further.

Gravestone Doji - This pattern is opposite to dragonfly doji i.e., it has long upper shadow and no or very small lower shadow. It is a bearish reversal candlestick pattern that indicates that price of an asset is likely to go down further.

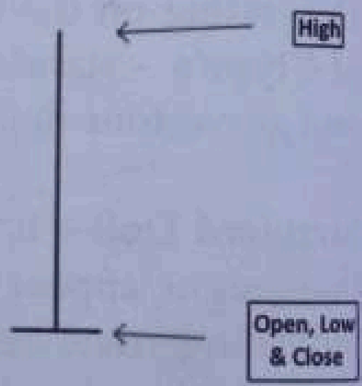


Standard Doji

Long Legged Doji



Dragonfly Doji



Gravestone Doji

Two Candlestick Patterns –

As the name indicates, such patterns are formed by two candles.

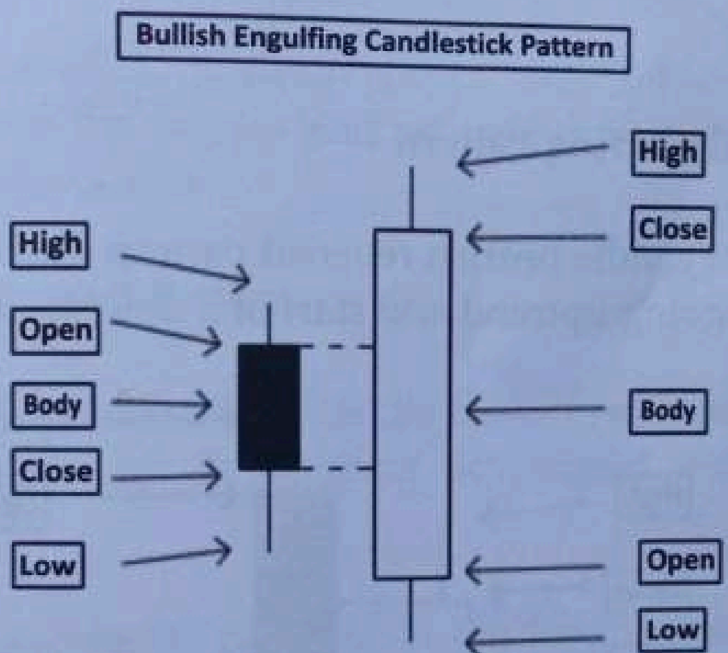
Popular Two Candlesticks Patterns include –

- Bullish Engulfing Pattern
- Bearish Engulfing Pattern
- Bullish Harami

- Bearish Harami
- Piercing Pattern
- Dark Cloud Cover

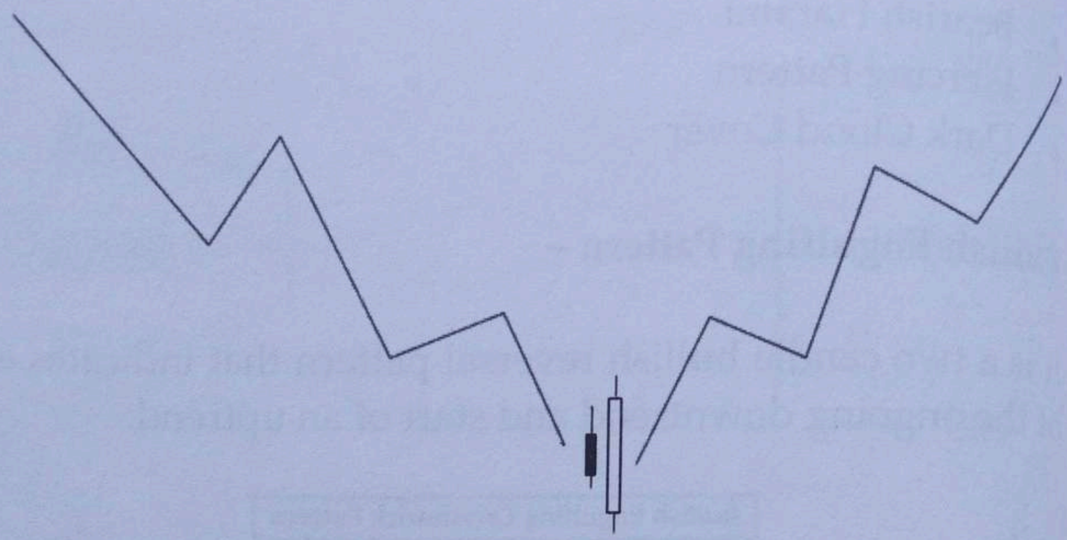
Bullish Engulfing Pattern -

It is a two candle bullish reversal pattern that indicates end of the ongoing downtrend and start of an uptrend.



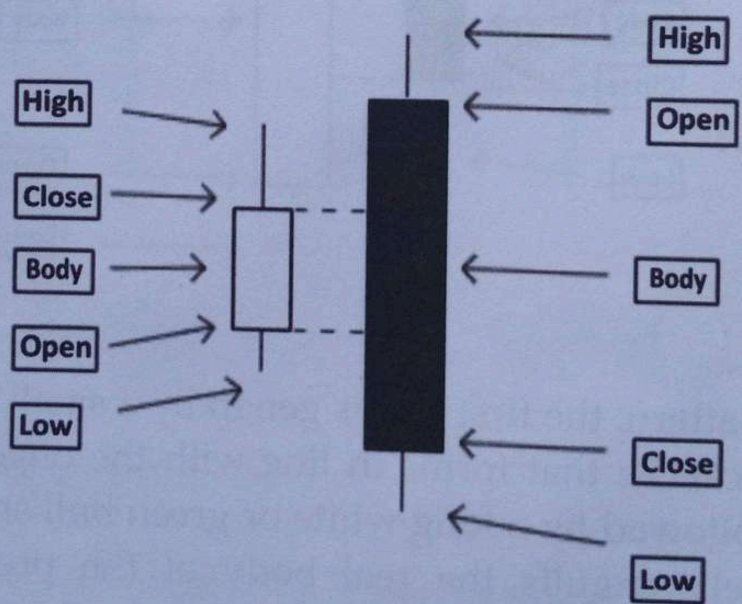
In this pattern, the first day is generally a small black or red bearish candle that forms in line with the ongoing bearish trend, followed by a long white or green bullish candle that completely engulfs the real body of the previous day's bearish candle.

This candlestick pattern shows that buyers have been dominating the sellers and buyers are more likely to take the price upward.



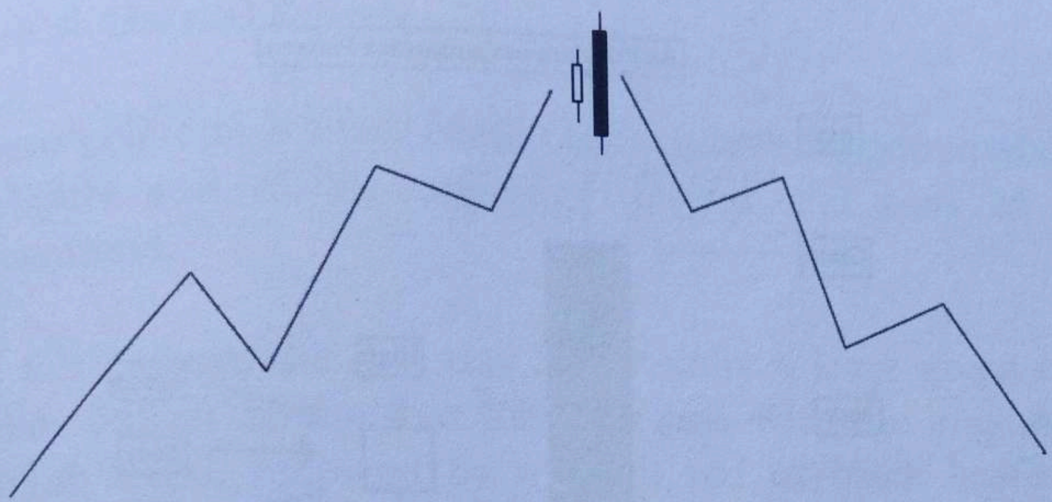
Bearish Engulfing Pattern -

It is a two candle bearish reversal pattern that indicates end of the ongoing uptrend and start of a downtrend.



Bearish Engulfing Candlestick Pattern

In this pattern, the first day is generally a small white or green bullish candle that forms in line with the ongoing bullish trend, followed by a long black or red bearish candle which completely engulfs the real body of the previous day's bullish candle.



This candlestick pattern shows that sellers have been dominating the buyers and sellers are more likely to take the price downward.

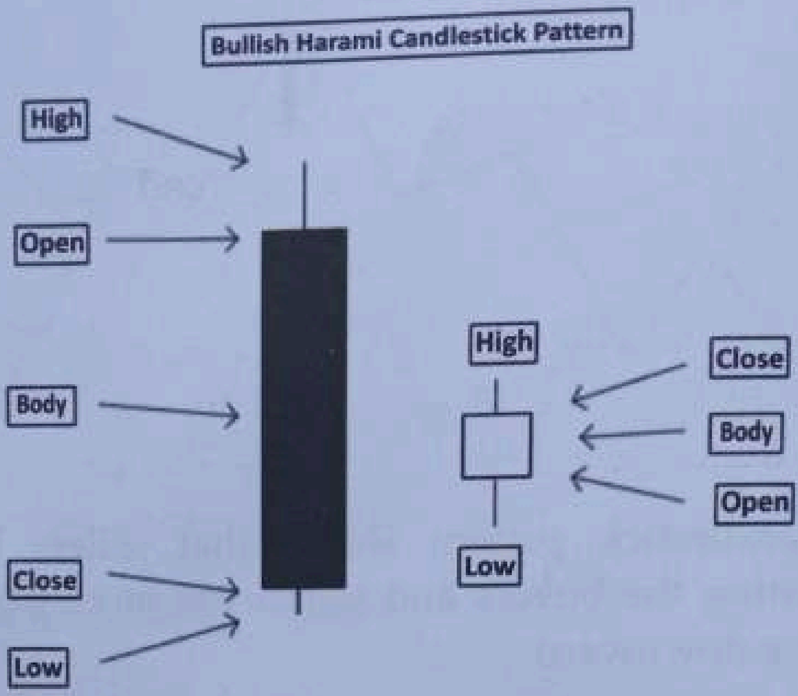
Bullish Harami Pattern –

Bullish Harami is a two candle bullish reversal pattern that indicates end of the ongoing downtrend and start of an uptrend.

Pattern derives its name from the Japanese word Harami which means a "Pregnant Woman" because the graphic that represents this pattern resembles a pregnant woman.

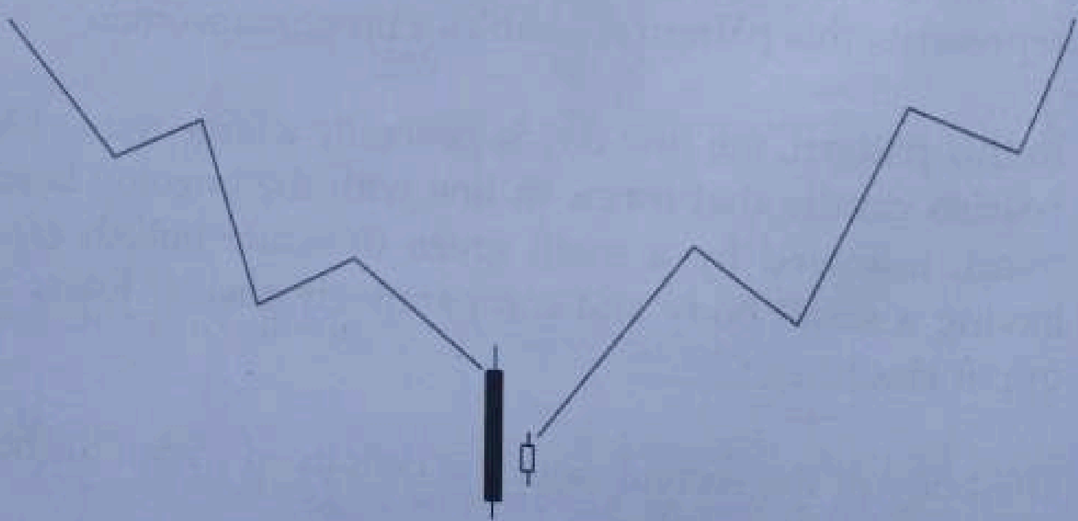
In this pattern, the first day is generally a large red or black bearish candle that forms in line with the ongoing bearish trend, followed by a small green or white bullish candle having a small body and comparatively smaller lower and upper shadows.

The body of the second candle is contained within the body of the previous candle.



Ideally, the size of the body of the larger candle should be approximately 4 times the size of the body of the smaller candle.

The pattern works better if the upper and lower shadow of white or green candle doesn't go beyond the black or red candle.

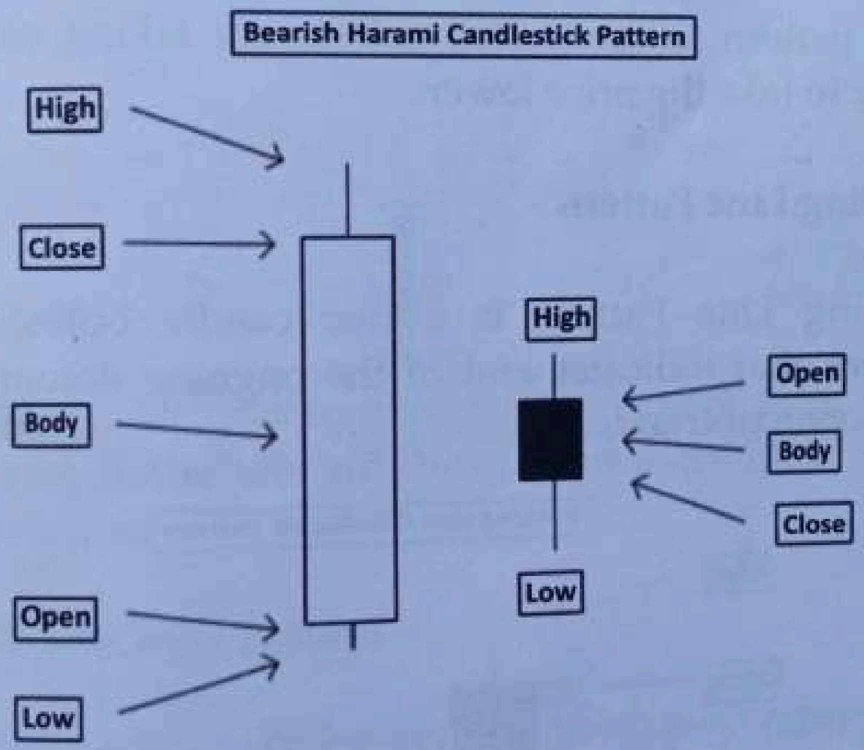


This pattern suggests that buyers are taking control and ready to take the price higher.

Bearish Harami Pattern -

Bearish Harami is a two candle bearish reversal pattern that indicates end of the ongoing uptrend and start of a downtrend.

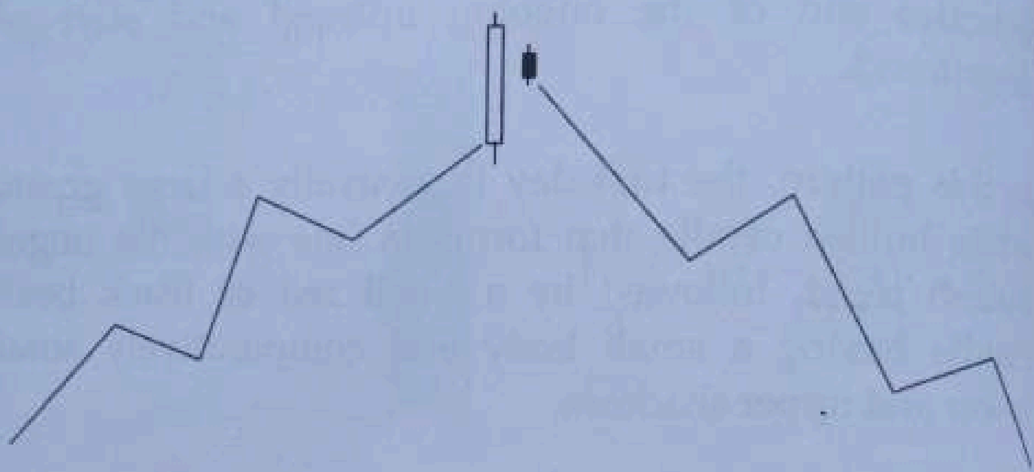
In this pattern, the first day is generally a large green or white bullish candle that forms in line with the ongoing bullish trend, followed by a small red or black bearish candle having a small body and comparatively smaller lower and upper shadows.



The body of the second candle is contained within the body of the previous candle.

Ideally, the size of the body of the larger candle should be approximately 4 times the size of the body of the smaller candle.

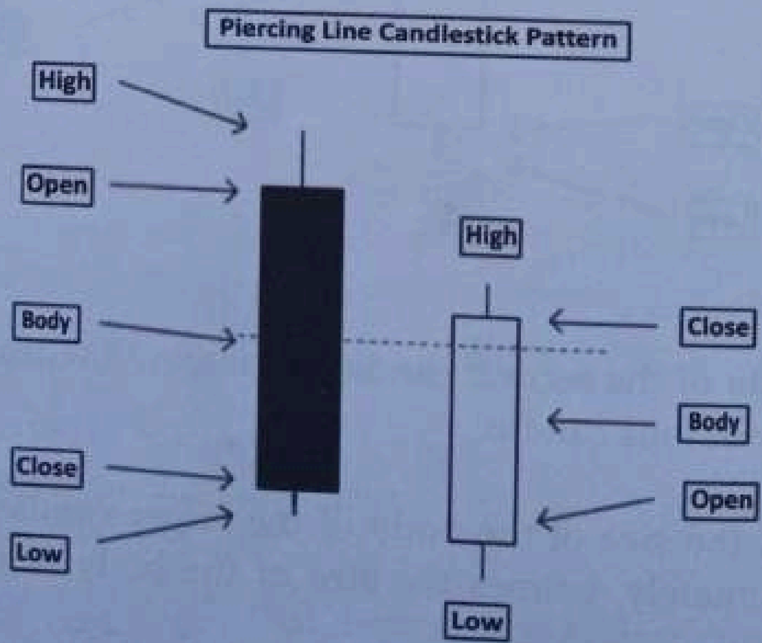
The pattern works better if the upper and lower shadow of red or black candle doesn't go beyond the green or white candle.



This pattern suggests that sellers are taking control and ready to take the price lower.

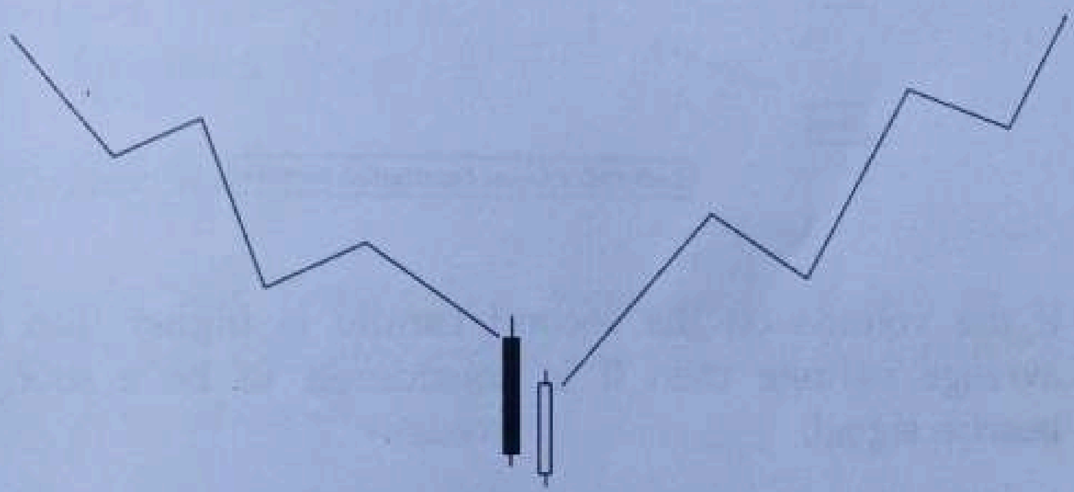
Piercing Line Pattern -

Piercing Line Pattern is a two candle bullish reversal pattern that indicates end of the ongoing downtrend and start of an uptrend.



In this pattern, the first day is generally a large red or black bearish candle that forms in line with ongoing bearish trend, followed by a strong green or white bullish candle that opens lower than previous days low but manages to close above the mid range of the previous candle.

If the volume of the second candle is higher than the average volume, then it is considered to be a stronger bullish signal.

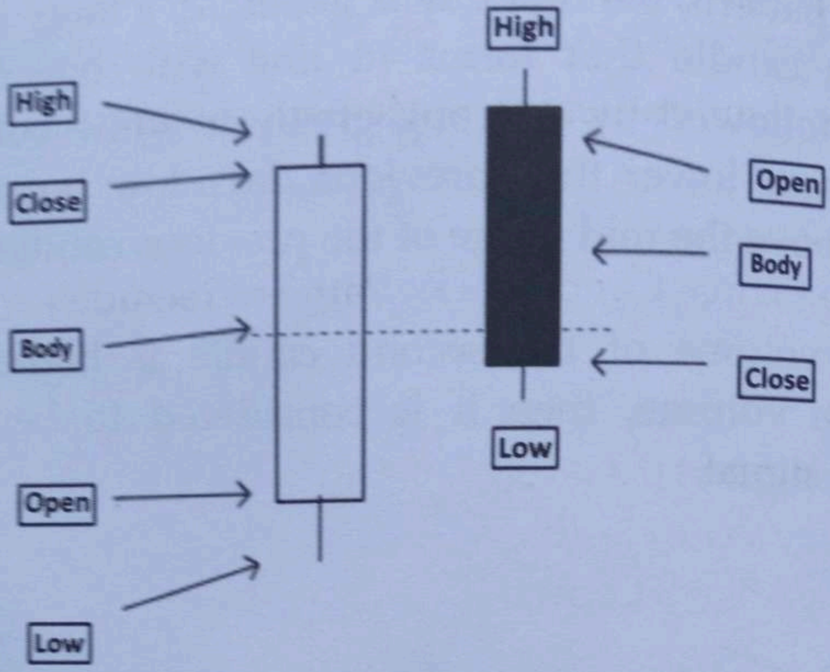


This candlestick pattern shows that buyers have started dominating the sellers and buyers are more likely to take the price higher.

Dark Cloud Cover Pattern -

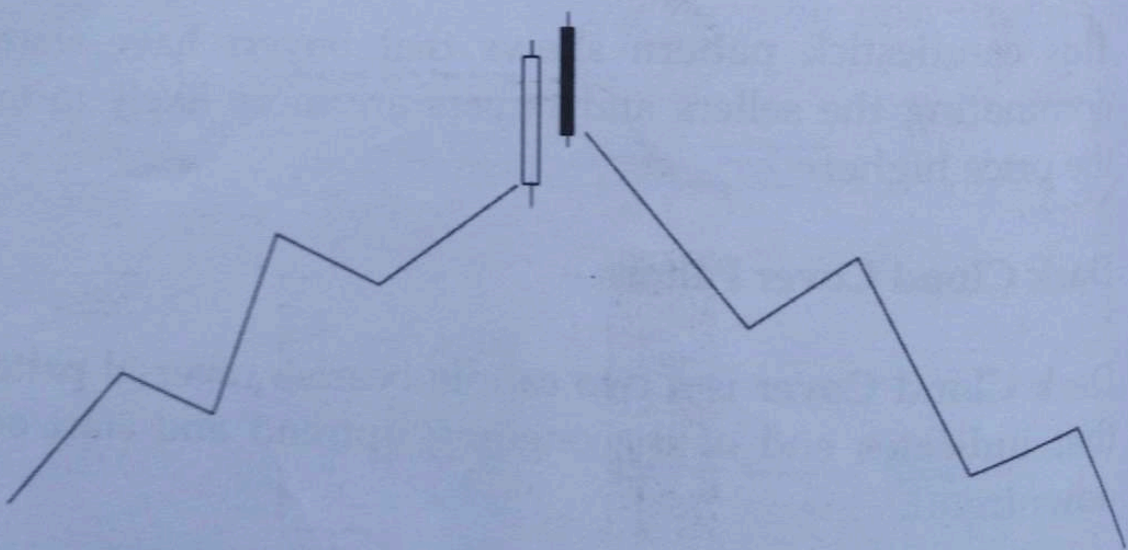
Dark Cloud Cover is a two candle bearish reversal pattern that indicates end of the ongoing uptrend and start of a downtrend.

In this pattern, the first day is generally a large green or white bullish candle that forms in line with the ongoing bullish trend, followed by a strong red or black bearish candle that opens higher than the previous days high but eventually manages to close below the mid range of the previous candle.



Dark Cloud Cover Candlestick Pattern

If the volume on the second candle is higher than the average volume then it is considered to be a stronger bearish signal.



This candlestick pattern shows that sellers have started dominating the buyers and sellers are more likely to take the price lower.

Three Candlestick Patterns -

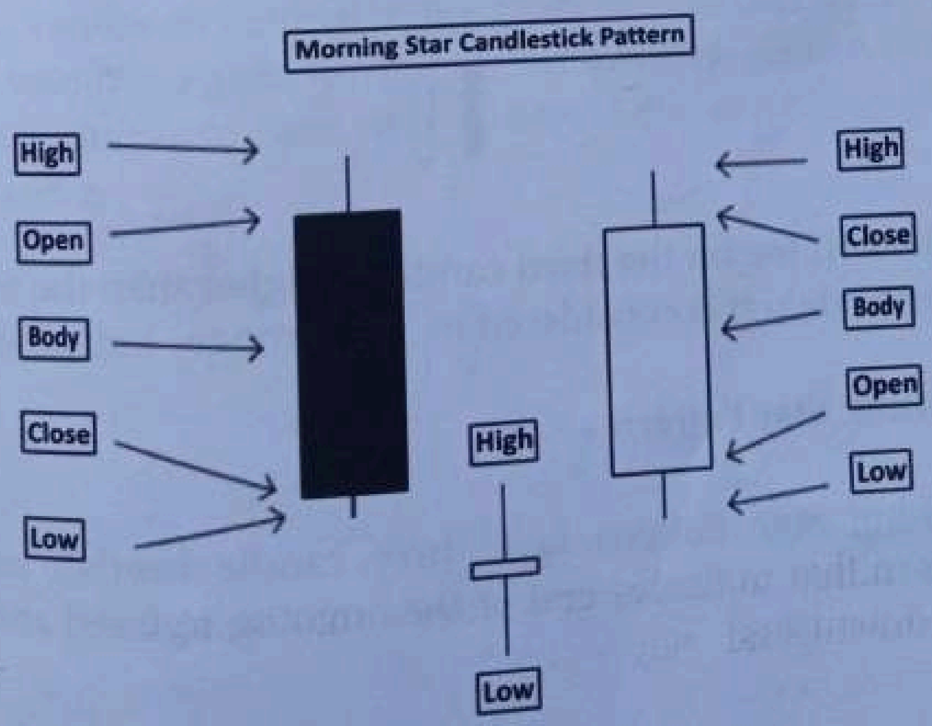
As the name indicates, such patterns are formed by three candles.

Popular Three Candlesticks Patterns include -

- Morning Star Pattern
- Evening Star Pattern
- Three White Soldiers
- Three Black Crows

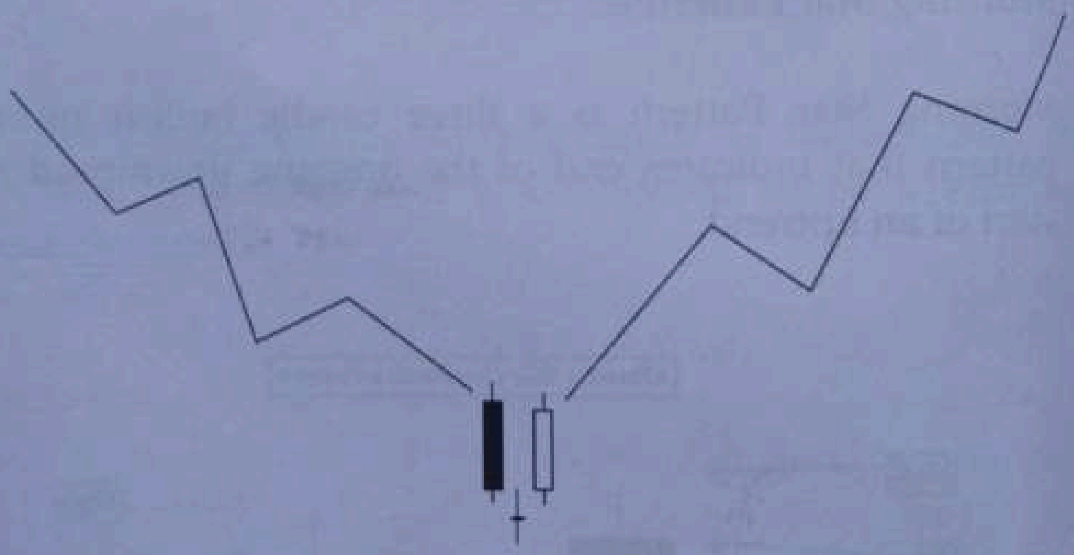
Morning Star Pattern -

Morning Star Pattern is a three candle bullish reversal pattern that indicates end of the ongoing downtrend and start of an uptrend.



In this pattern, the first day is generally a large red or black bearish candle that forms in line with the ongoing bearish trend, followed by a gap down small body candle. This second candle can either be a bullish or bearish candle. The third candle is a gap up long green or white bullish candle that manages to close near or above the mid range of the first candle.

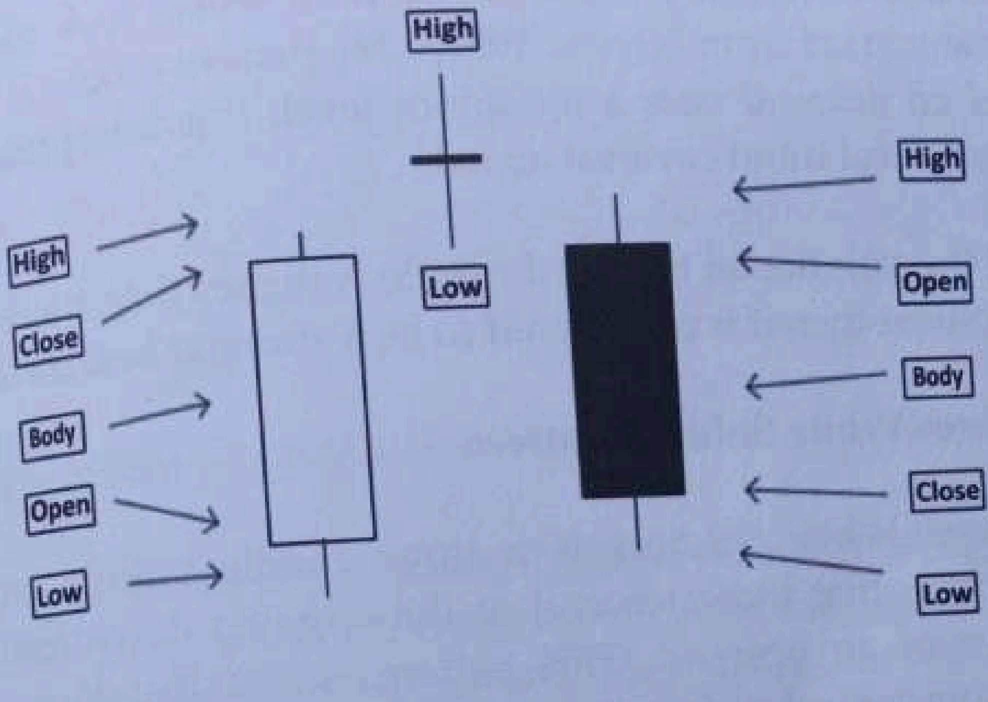
This candlestick pattern shows how buyers took control of the market from sellers. When this pattern occurs at the bottom of downtrend near a support level, it is interpreted as a powerful trend reversal signal.



If the volume on the third candle is higher than the average volume then it is considered to be a stronger bullish signal.

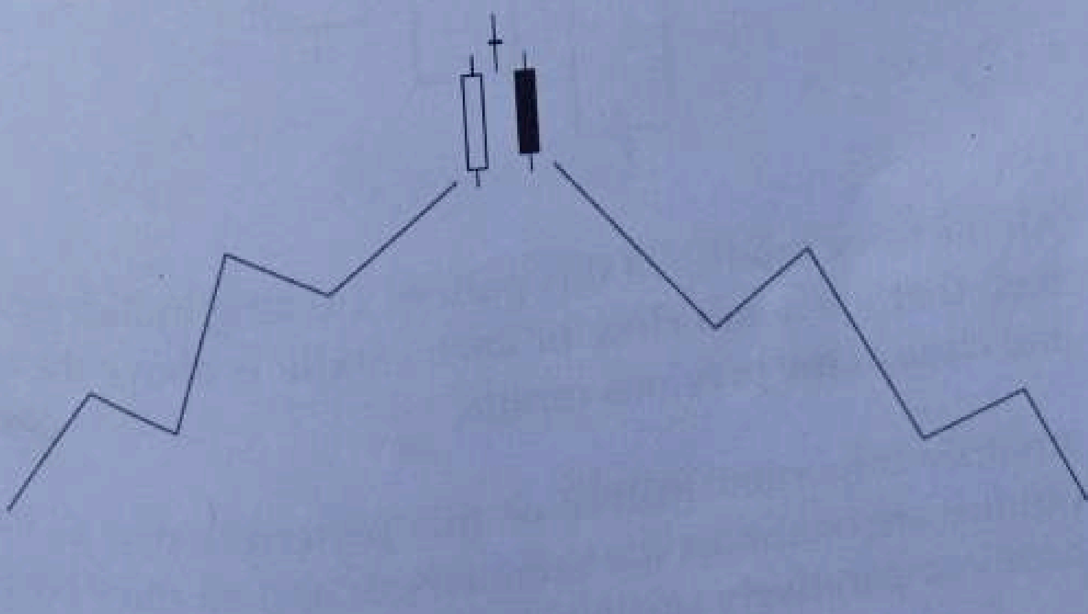
Evening Star Pattern –

Evening Star Pattern is a three candle bearish reversal pattern that indicates end of the ongoing uptrend and start of a downtrend.



Evening Star Candlestick Pattern

In this pattern, the first day is generally a large green or white bullish candle that forms in line with the ongoing bullish trend, followed by a gap up small body candle. This second candle can either be a bullish or bearish candle. The third candle is a gap down long red or black bearish candle which manages to close near or below the mid range of the first candle.

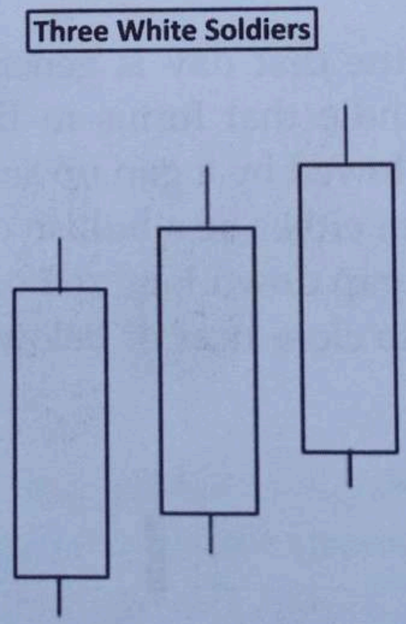


This candlestick pattern shows how sellers took control of the market from buyers. When this pattern occurs at the top of an uptrend near a resistance level, it is interpreted as a powerful trend reversal signal.

If the volume on the third candle is higher than the average volume then it is considered to be a stronger bearish signal.

Three White Soldiers Pattern –

Three White Soldiers is a three candle bullish reversal pattern that indicates end of the ongoing downtrend and start of an uptrend. This pattern shows that buyers are taking control and the price is expected to move higher.

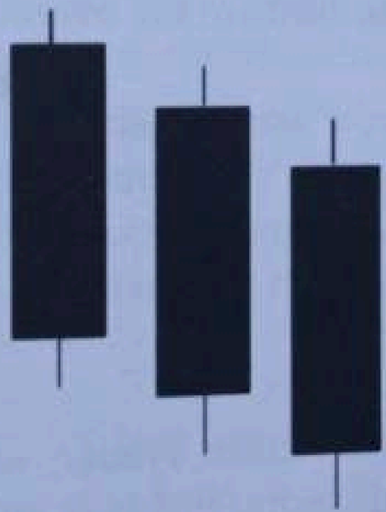


All the three candles of this pattern are long bullish candles such that open and close of each candle is above the open and close of the previous candle.

Another important feature of this pattern is that all three candles are of almost the same length and all three candles have comparatively smaller shadows.

Three Black Crows Pattern -

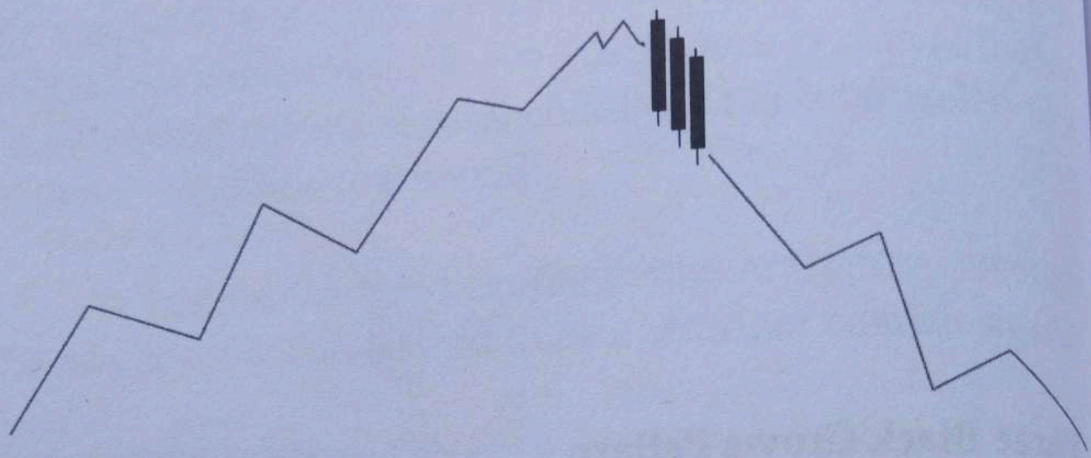
Three Black Crows is a three candle bearish reversal pattern that indicates end of the ongoing uptrend and start of a downtrend. This pattern shows that sellers are taking control and price is expected to move lower.



Three Black Crows

All the three candles of this pattern are long bearish candles such that open and close of each candle is below the open and close of the previous candle.

Another important feature of this pattern is that all three candles are of almost the same length and all three candles have comparatively smaller shadows.



Important Notes :

Although candlestick patterns capture the attention of market players, they should never be traded upon in isolation. They should be used alongside other tools of technical analysis to confirm the overall trend.

For example, if you are focusing on the volume of the security for additional confirmation then if you get any trading signal using candlesticks pattern accompanied by rising volume then such a signal is considered to be a very strong trading signal.

Although as a Price Action Trader, we are not concerned with Technical Indicators, but it is still advised to look at Moving Average to get additional confirmation.

Another thing to remember is that there is no best or worst candlestick pattern. You have to figure out patterns that work for you and then stick to them.

If you are a beginner then I would request you to see more and more charts and try to identify candlestick patterns so that your eyes get trained to spot them easily.

ADVANCE ANALYSIS OF CANDLESTICKS

In the previous chapter, I had introduced you to candlesticks and explained important candlestick patterns. In this chapter, I shall explain how experienced traders look at these candles and gain important information from them and trade accordingly.

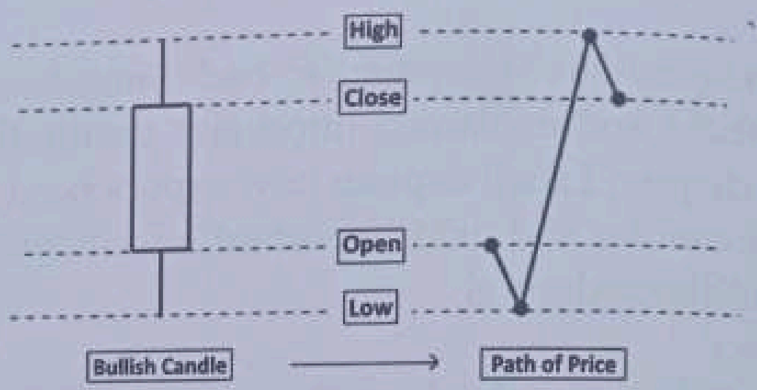
Candlesticks not only show the open, high, low and close prices, if analyzed properly in conjunction with volume, then they also tell a lot about what buyers and sellers are doing, strength of buyers and sellers, strength of trend, momentum, etc.

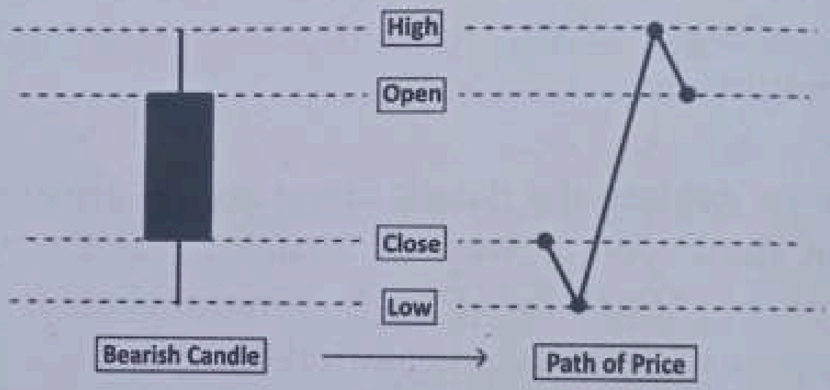
Before we get into the details about how to analyze candles, let me show you a way to visualize candles using the concept of ***"Path of Price"***. This makes it easy for newcomers to understand candlesticks.

A path of price is nothing but a way in which a candle gets formed so if you notice for an instance let's say the price of a security opened at Rs. 50 and went below Rs. 40 and then made a high of Rs. 75 and eventually closing the trading session at Rs. 70 then this type of path of price information, when represented via candlestick becomes a bullish candle formation.

In simple words, a path of price shows you the psychology behind the bullish or bearish candlestick formation.

On the next page, I shall explain this with help of a few infographics.





Detailed Analysis of Candlesticks:

To analyze candlesticks in details, we need to pay close attention to 4 things –

1. Size of the Candlestick Body
2. Length of the Shadow
3. Body to Shadow Ratio
4. Position of the Candlestick Body

Important Note: Never look only at one or more of the above mentioned aspects of candlestick in isolation, use them together to get a complete picture of what is happening.

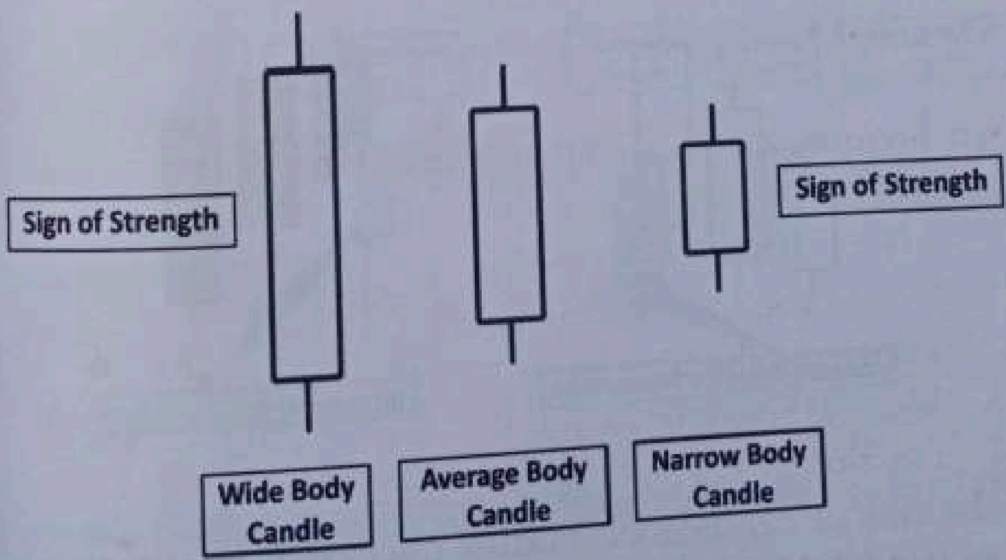
Size of the Candlestick Body -

The size of the candlestick's body signifies how strong the dominance is in a bullish or bearish environment.

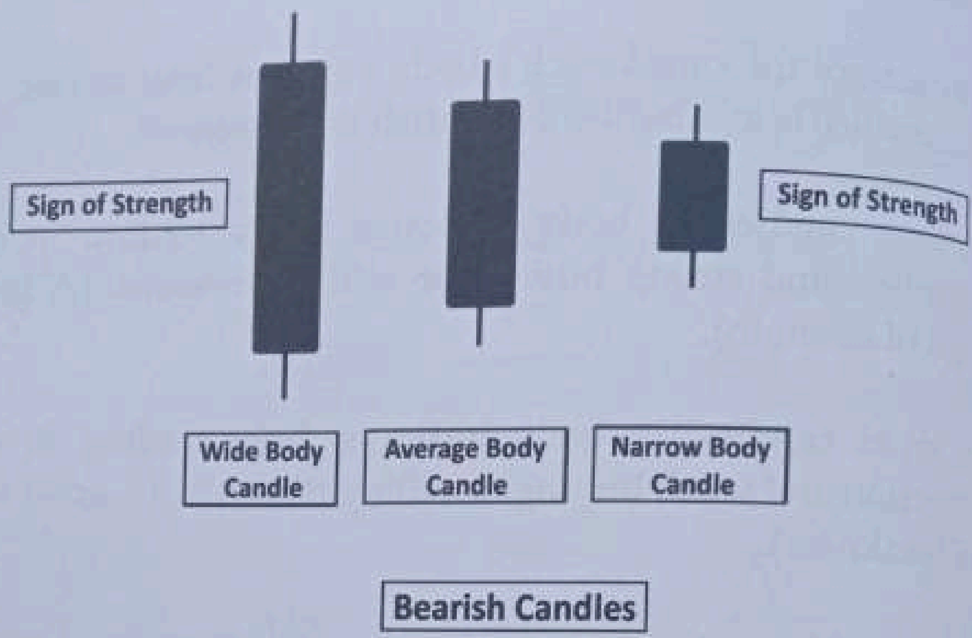
A long candlestick body indicates heavy trading in one direction and strong buying or selling pressure. (A good sign of strength).

A short candlestick body indicates light trading in one direction and weak buying or selling pressure. (A good sign of weakness).

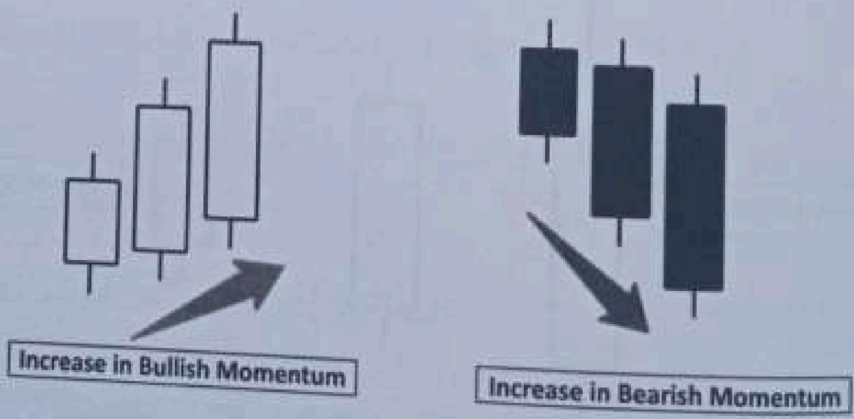
While taking a long or short trading position just keep in mind that if the body of the candle is wide then the probability of the trade going in your favor will become more and vice-versa.



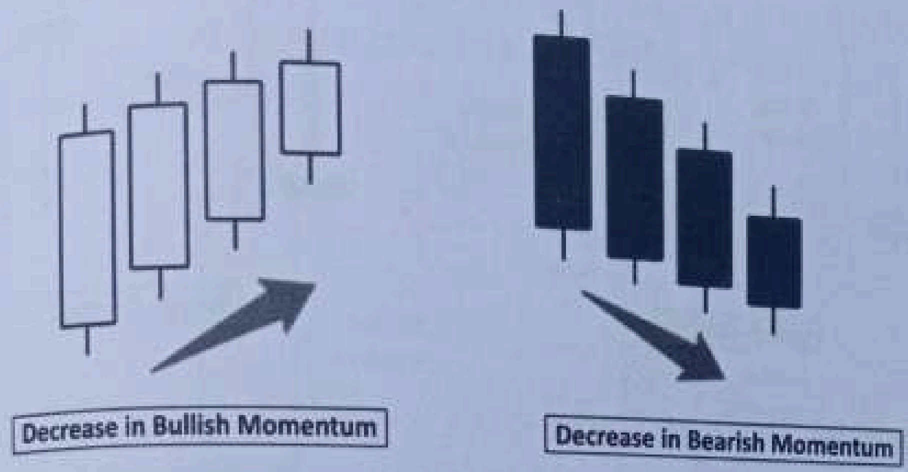
Bullish Candles



If the size of candlestick bodies increases over a period of time (preferably a few consecutive candles) then it indicates momentum of the prevailing trend is increasing. During such a phase, never trade against the trend.



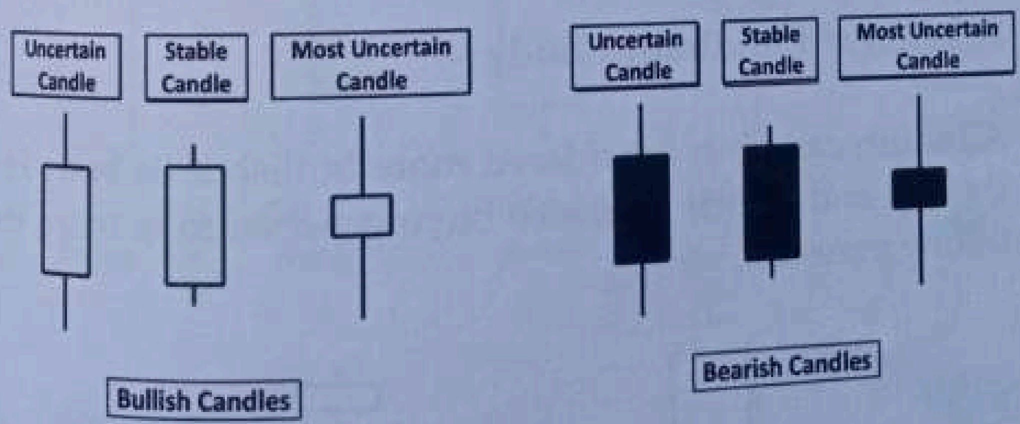
If the size of candlestick bodies decreases over a period of time (preferably a few consecutive candles) then it indicates momentum of the prevailing trend is decreasing and it may soon come to an end. During such periods, watch out for reversal signs.



If candlestick bodies remain more or less constant then it indicates a steady trend.

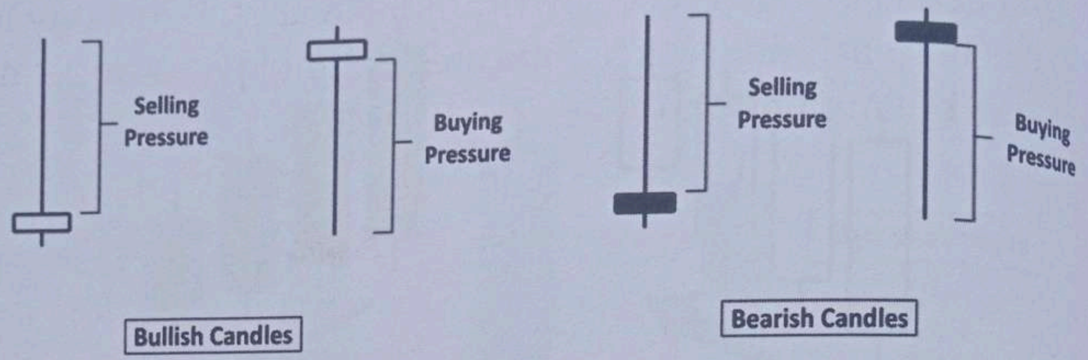
Length of the Candlestick Body –

Long shadows can be a sign of uncertainty while short shadows can be a sign of a stable market with less uncertainty.



The upper shadow indicates selling pressure or rejection of higher price.

The lower shadow indicates buying pressure or rejection of lower price.



Body to Shadow Ratio –

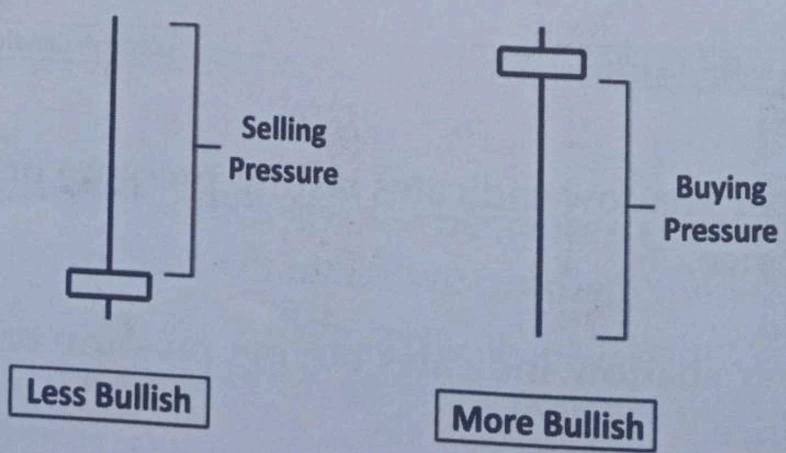
Candlestick bodies are significantly longer than shadows during strong trends.

When the trend weakens, the shadows of candles start becoming bigger than candlestick bodies.

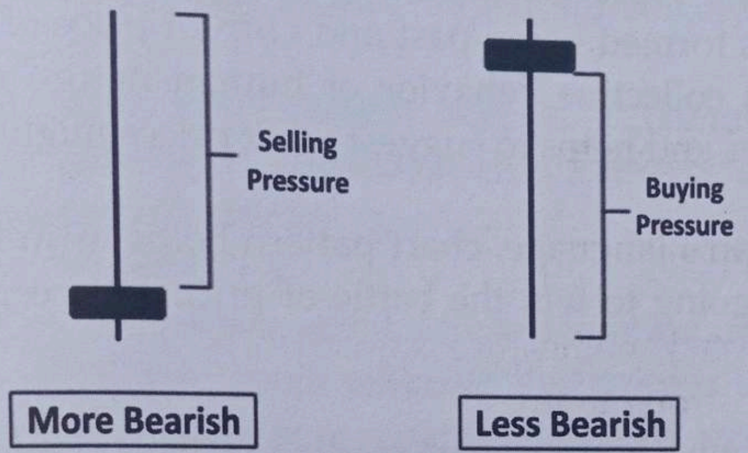
In case of sideways movement or consolidation phase or when the trend is about to reverse, candlesticks have a long shadow and short bodies.

Position of Candlestick Body –

A bullish candle is considered more bullish if its body is on the top end which indicates buying pressure is more than selling pressure.



A bearish candle is considered more bearish if its body is on the bottom end which indicates selling pressure is more than buying pressure.



Now I shall summarize all the points explained above in form of two tables showing bullish and bearish candles in order of their strength.

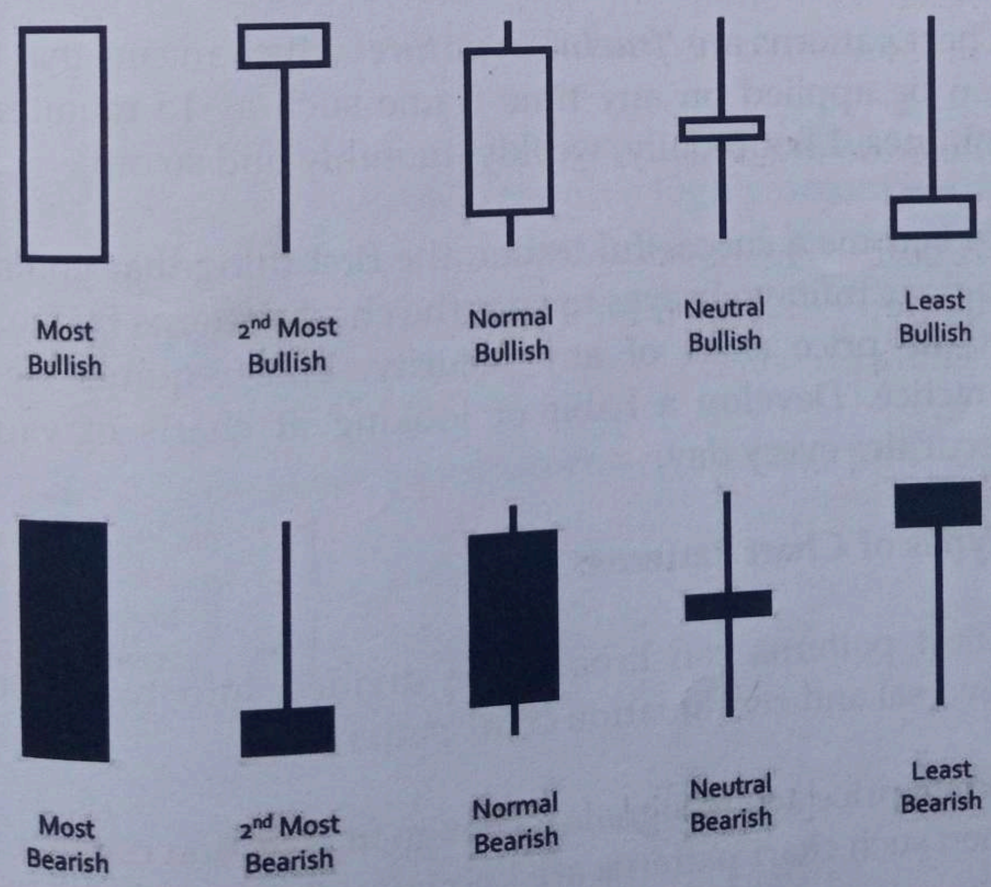


CHART PATTERNS

A chart pattern is an integral aspect of Technical Analysis. It is a visual representation of price movement of a security which is formed using past and current price of an asset. It signifies collective behavior of human nature on price of securities and helps to suggest what prices might do next.

In layman's language, chart pattern helps us in finding out who is going to win the battle of price, between bulls and bears.

Traders who possess chart reading skills and apply them in buying and selling decisions increase their odds of being on the right side of the trend. Hence if you are starting your trading journey then it is important for you to learn to spot and interpret Chart Patterns.

Chart patterns are ***'fractal in nature'*** which means that they can be applied on any time frame such as 15 minutes, 30 minutes, 1 hour, daily, weekly, monthly and so on.

To become a successful trader, the first thing that you need to do is train your eyes to spot the chart patterns by looking at the price chart of any security. This requires regular practice. Develop a habit of looking at charts of various securities every day.

Types of Chart Patterns:

Chart patterns can broadly be divided into two types - reversal and continuation chart patterns.

When price action signals a change in direction of the trend, then such chart patterns are known as ***Reversal Patterns.***

In simple words, if you come across a reversal pattern during an uptrend then it indicates that price is likely to go down and if you spot a reversal pattern during a downtrend then it signals that price is more likely to go up.

Similarly, when price action signals a continuation in direction of the trend, then such chart patterns are known as ***Continuation Patterns***.

In simple words, if you come across a continuation pattern during an uptrend then it indicates that price is likely to go up further and if you spot a continuation pattern during a downtrend then it signals that the price is more likely to go down further.

There are also few ***Neutral Patterns***, which depending on the direction of the breakout can indicate either reversal or continuation of the previous trend.

There are numerous chart patterns, but as a trader, our job is to master chart patterns that give highly accurate results and are frequently seen on charts. Below I have explained the most important Chart Patterns which can be applied to most financial markets.

Important Reversal Chart Patterns:

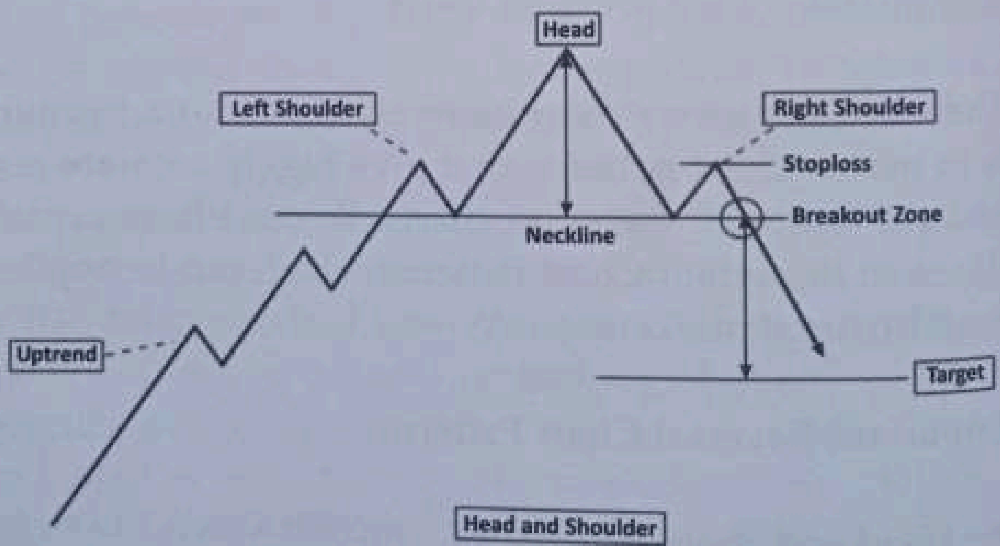
- Head and Shoulder
- Inverted Head and Shoulder
- Double Top
- Double Bottom
- Rounding Bottom
- Rounding Top

Head and Shoulder –

It is a popular, easy-to-spot and one of the most reliable trend reversal patterns.

It is a bearish reversal pattern that appears after a defined uptrend and signifies a meaningful reversal on completion of the pattern. This pattern shows that buyers have lost the battle and the price is likely to go down from hereon.

As seen in the chart below, this pattern is formed by three peaks, wherein 1st peak is known as the left shoulder, 2nd peak (highest one) is known as the head and the 3rd peak is known as the right shoulder. The line formed by connecting the bottom of the left and right shoulder is known as the neckline. The pattern is said to be complete only when the price breaks the neckline on the downside.



As seen in the chart above, after a long bullish trend, the price rises to a peak and subsequently declines to form a trough. The price rises again to form a second high substantially above the initial peak and declines again. The price rises again for the third time, but only to the level of the first peak, before declining again to the neckline.

Now, a short entry is taken once the price breaks the neckline on the downside.

The potential target for the pattern is normally calculated below the neckline equal to the price difference between the high point of the head and the neckline.

Stop loss will be placed at the edge of the right shoulder as shown in the figure on the previous page.

The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks below the neckline.

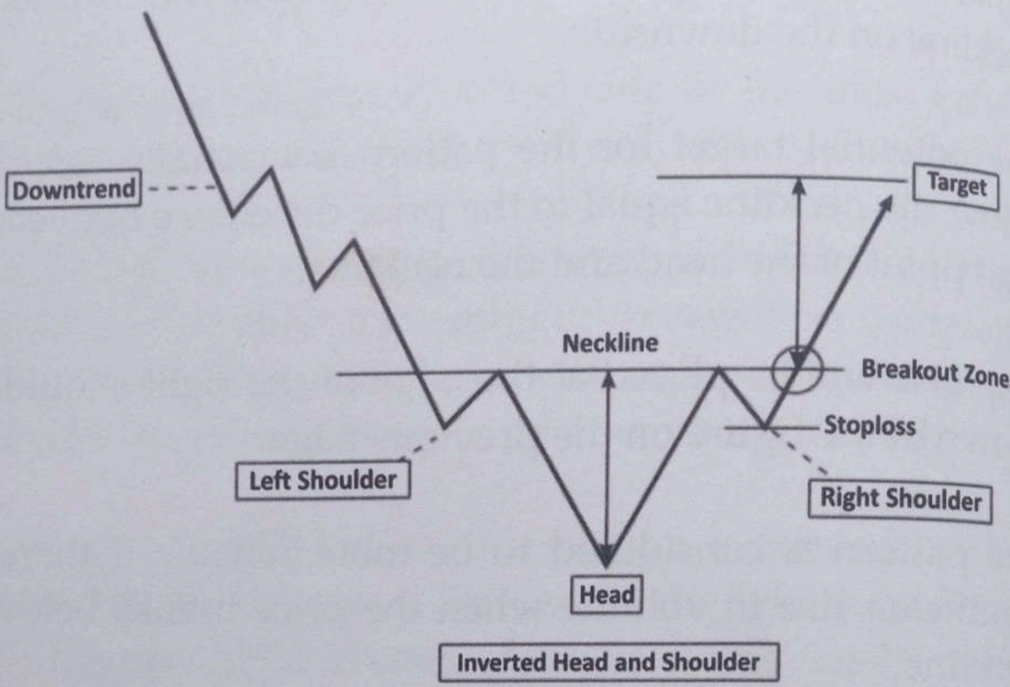
Inverted Head and Shoulder -

As the name indicates, it is an inverted version of the head and shoulder pattern explained above.

It is a bullish reversal pattern that appears after a defined downtrend and signifies a meaningful reversal on completion of the pattern.

This pattern shows that sellers have lost the battle and the price is likely to go up from hereon.

As seen in the chart below, this pattern is formed by three lows, wherein 1st low is known as the left shoulder, 2nd low (lowest one) is known as the head and the 3rd low is known as the right shoulder. The line formed by connecting the top of the left and right shoulder is known as the neckline. The pattern is said to be complete only when the price breaks the neckline on the upside.



As seen in the chart above, after a long bearish trend, the price falls to a trough and subsequently rises to form a peak. The price falls again to form a second low substantially below the initial low and rises again. The price falls again for the third time, but only to the level of the first low, before rising again to the neckline.

Now, a long entry is taken once the price breaks the neckline on the upside.

The potential target for the pattern is normally calculated above the neckline equal to the price difference between the low point of the head and the neckline.

Stop loss will be placed at the edge of the left shoulder as shown in the figure above.

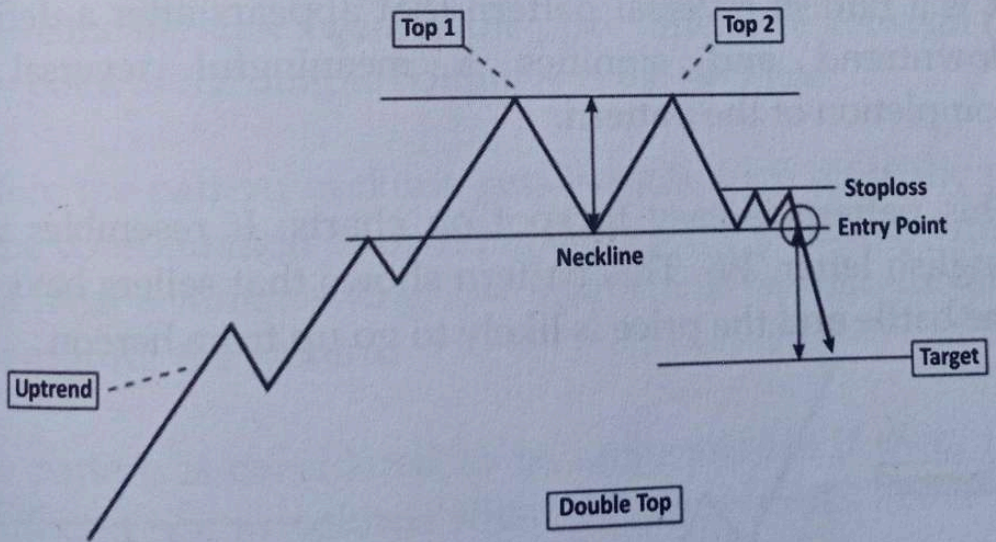
The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks above the neckline.

Double Top –

It is a bearish reversal pattern that appears after a defined uptrend and signifies a meaningful reversal on completion of the pattern.

This pattern is easy to spot on charts. It resembles with English letter 'M'. This pattern shows that buyers have lost the battle and the price is likely to go down from hereon.

As seen in the chart below, this pattern is formed by two consecutive tops and a moderate decline between the two tops. The horizontal line drawn at the bottom formed between the two tops is known as the neckline. The pattern is said to be complete only when the price breaks the neckline on the downside.



As seen in the chart above, after a long bullish trend, the price rises to form a top and then retraces back to some extent to form a bottom. The price rises again to form a second top which is almost equal to the first top, before declining again to the neckline.

Now, a short entry is taken once the price breaks the neckline on the downside.

The potential target for the pattern is normally calculated below the neckline equal to the price difference between the high point of the double top and the neckline.

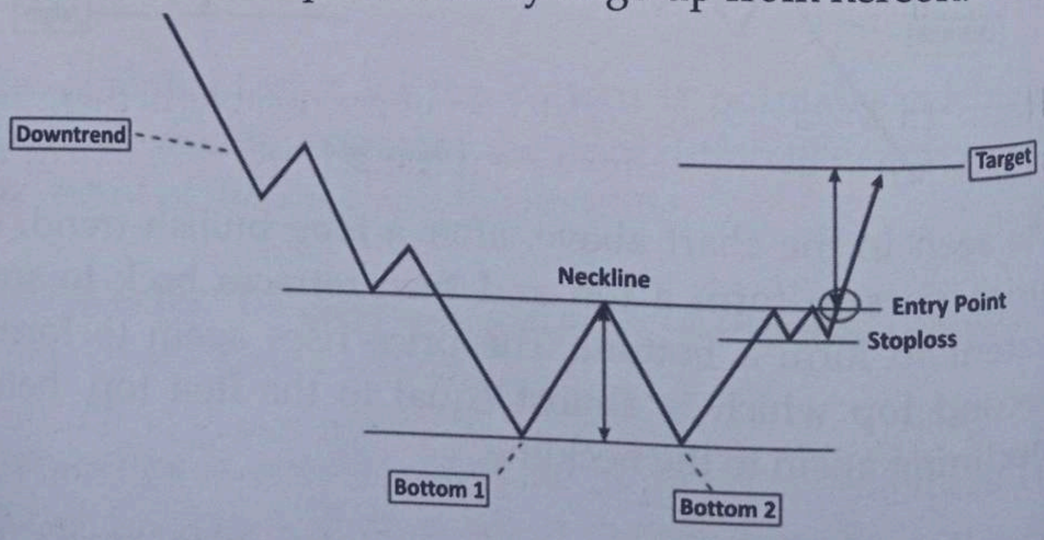
Before the pattern neckline gets breached we normally see some consolidation happening before the breakout which will form a minor swing high and it will become the stop loss area for the pattern. The right placement of stop loss will give us a favorable risk and reward ratio.

The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks below the neckline.

Double Bottom –

It is a bullish reversal pattern that appears after a defined downtrend and signifies a meaningful reversal on completion of the pattern.

This pattern is easy to spot on charts. It resembles with English letter 'W'. This pattern shows that sellers have lost the battle and the price is likely to go up from hereon.



Double Bottom

As seen in the chart on the previous page, this pattern is formed by two consecutive bottoms and a moderate rise between the two bottoms. The horizontal line drawn at the peak formed between the two bottoms is known as the neckline. The pattern is said to be complete only when the price breaks the neckline on the upside.

After a long bearish trend, the price falls to form a bottom and then retraces back to some extent to form a top. The price falls again to form a second bottom which is almost equal to the first bottom, before rising again to the neckline.

Now, a long entry is taken once the price breaks the neckline on the upside.

The potential target for the pattern is normally calculated above the neckline equal to the price difference between the low point of the double bottom and the neckline.

Before the pattern neckline gets breached we normally see some consolidation happening before the breakout which will form a minor swing low and it will become the stop loss area for the pattern.

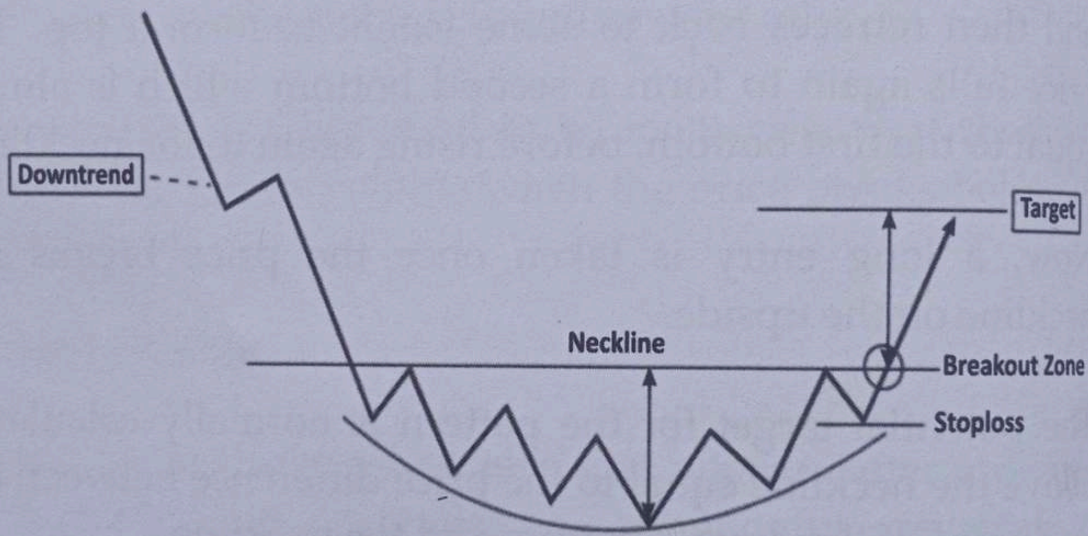
The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks above the neckline.

Rounding Bottom –

It is a long-term bullish reversal pattern that appears after a defined downtrend and a long period of consolidation and signifies a meaningful reversal on completion of the pattern.

This pattern is easy to spot on charts. Because its appearance is similar to the bottom of a bowl or a saucer, the pattern is also known as a saucer bottom pattern.

This pattern shows that after a period of consolidation, sellers have lost the battle and price is likely to go up from hereon.



Rounding Bottom

As seen in the chart above, this pattern is formed during a period of consolidation after a downtrend. During this period the fall in price is slowly arrested, a bottom is formed and then price slowly starts rising.

The horizontal line drawn across the top of the bearish and bullish sides of the rounding bottom pattern is known as the neckline. The pattern is said to be complete only when the price breaks the neckline on the upside.

Now, a long entry is taken once the price breaks the neckline on the upside.

The potential target for the pattern is normally calculated above the neckline equal to the price difference between the low point of the rounding bottom and the neckline.

In case of this pattern, the stop loss will be placed at the swing low which occurs before the price breaks the neckline on the upside as shown in the figure on the previous page. This will give us a favorable risk to reward ratio.

The pattern is considered to be more reliable if you notice high volumes during the downtrend followed by flat or low volumes during the consolidation period and again increased volume when price breaks above the neckline.

This pattern is generally considered a long term pattern and hence it gives a clear signal when formed on weekly or monthly charts.

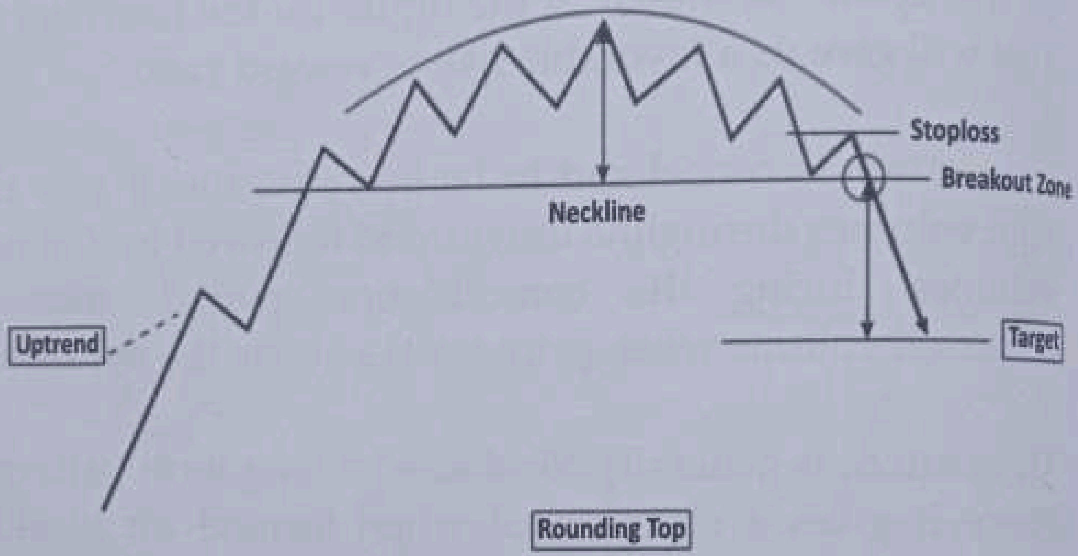
Rounding Top –

It is a long-term bearish reversal pattern that appears after a defined uptrend and a long period of consolidation and signifies a meaningful reversal on completion of the pattern.

This pattern is easy to spot on charts. It looks completely opposite to the rounding bottom pattern and is also known as an inverted saucer bottom pattern. This pattern shows that after a period of consolidation, buyers have lost the battle and price is likely to go down from hereon.

As seen in the chart on the next page, this pattern is formed during a period of consolidation after an uptrend. During this period the price rise is slowly arrested, a top is formed

and then the price slowly starts falling. The horizontal line drawn across the bottom of the bearish and bullish sides of the rounding top pattern is known as the neckline. The pattern is said to be complete only when the price breaks the neckline on the downside.



Now, a short entry is taken once the price breaks the neckline on the downside.

The potential target for the pattern is normally calculated below the neckline equal to the price difference between the high point of the rounding top and the neckline.

In case of this pattern, the stop loss will be placed at the swing high which occurs before the price breaks the neckline on the downside as shown in the figure on the previous page. This will give us a favorable risk to reward ratio.

The pattern is considered to be more reliable if you notice high volumes during the uptrend followed by flat or low volumes during the consolidation period and again increased volume when price breaks below the neckline.

This pattern is generally considered a long term pattern and hence it gives a clear signal when formed on weekly or monthly charts.

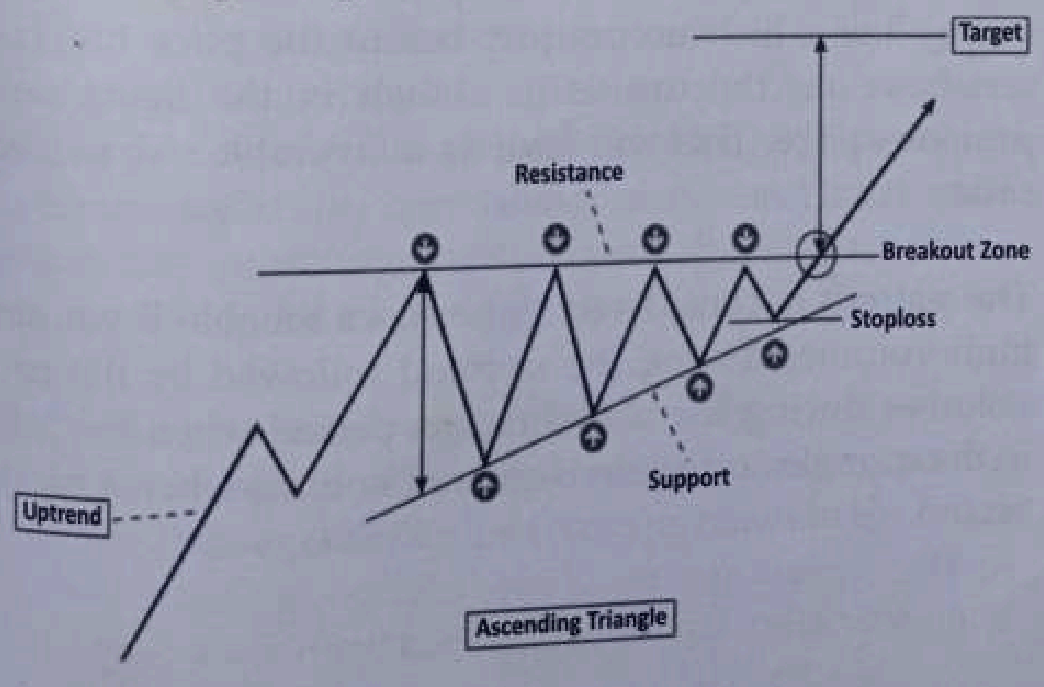
Important Continuation Chart Patterns:

- Ascending Triangle
- Descending Triangle
- Bullish Rectangle Pattern
- Bearish Rectangle Pattern
- Cup and Handle Pattern
- Inverted Cup and Handle

Ascending Triangle -

It is a bullish continuation pattern that occurs in an uptrend and signals that the price of the security will continue to trend higher on completion of the pattern.

This pattern shows that buyers are getting very aggressive and are likely to take prices even higher once the price breaks through the pattern.



As seen in the chart on the previous page, this pattern is formed between a rising lower trend line (Support Line) and a flat horizontal trend line (Resistance Line). This shows a continuation in the prevailing trend and indicates that buyers are more aggressive than sellers as the price continues to make higher lows.

The pattern is said to be complete only when a breakout happens on the continuation side, i.e., price breaks the resistance. This is when; a long entry is taken in the security.

It is a very powerful continuation chart pattern so if a trader has missed the uptrend earlier then he can use this opportunity to enter the security after a breakout on the higher side.

The potential target for the pattern is normally calculated by projecting the height of the ascending triangle at its thickest point above the breakout point.

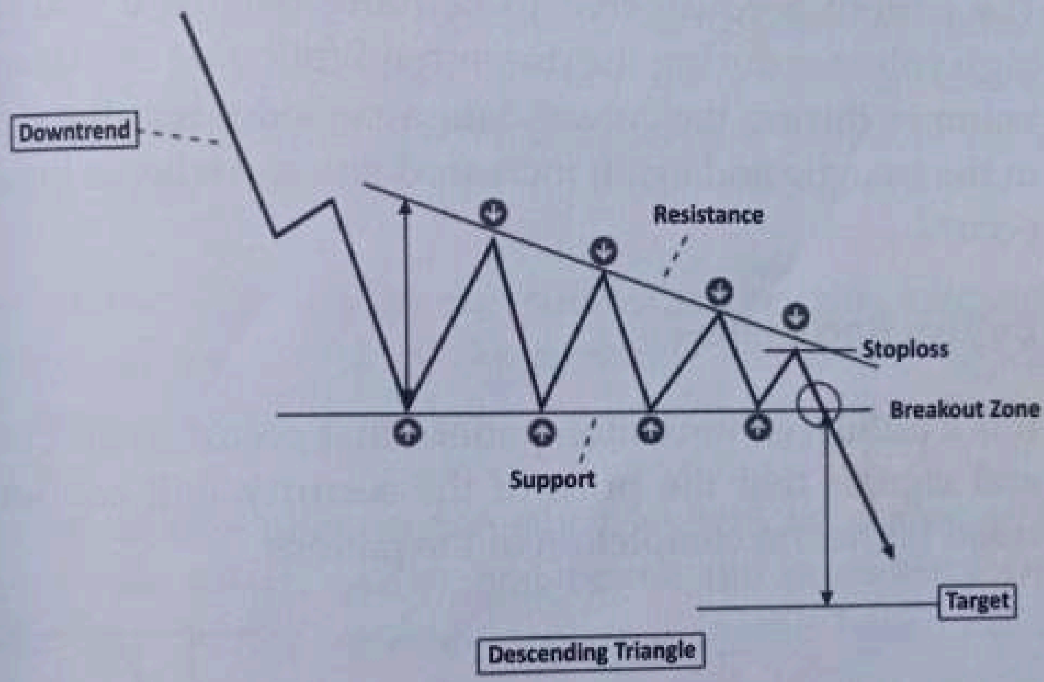
In case of this pattern, the stop loss will be placed at the swing low which occurs just before the price breaks the resistance on the upside as shown in the figure on the previous page. This will give us a favorable risk to reward ratio.

The pattern is considered to be more reliable if you notice high volumes during the uptrend followed by flat or low volumes during the consolidation period when the price is in the triangle and again increased volume when a breakout occurs.

Descending Triangle -

It is a bearish continuation pattern that occurs in a downtrend and signals that the price of the security will continue to trend lower on completion of the pattern.

This pattern shows that sellers are getting very aggressive and are likely to take prices even lower once the price breaks through the pattern.



As seen in the chart above, this pattern is formed between a falling upper trend line (Resistance Line) and a flat horizontal trend line (Support Line). This shows a continuation in the prevailing trend and indicates that sellers are more aggressive than buyers as the price continues to make lower highs.

The pattern is said to be complete only when a breakout happens on the continuation side i.e., price breaks the support. This is when; a short entry is taken in the security.

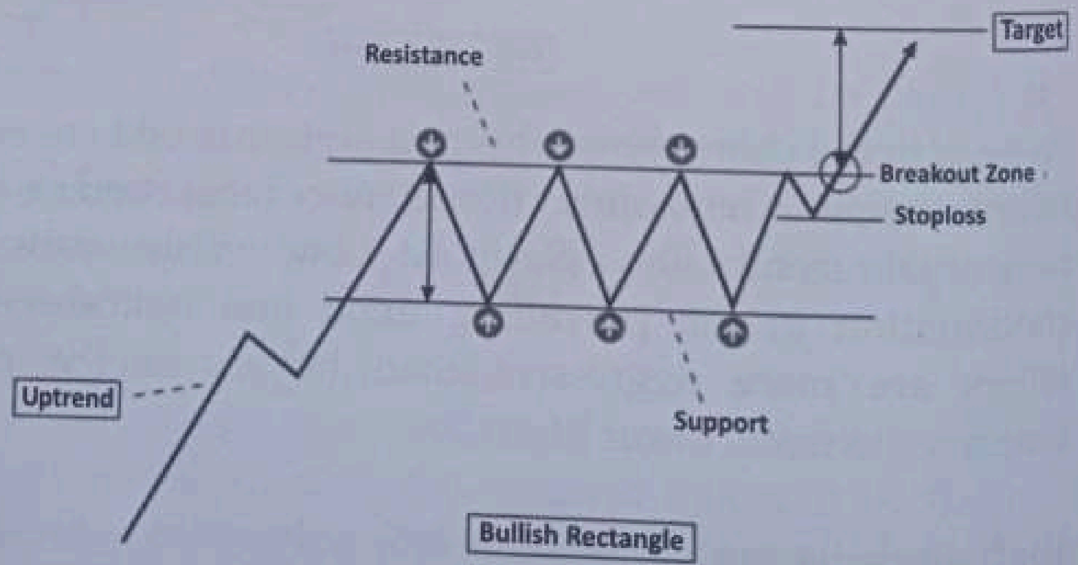
The potential target for the pattern is normally calculated by projecting the height of the descending triangle at its thickest point below the breakout point.

In case of this pattern, the stop loss will be placed at the swing high which occurs just before the price breaks the support on the downside as shown in the figure on the previous page.

The pattern is considered to be more reliable if you notice high volumes during the downtrend followed by flat or low volumes during the consolidation period when the price is in the triangle and again increased volume when a breakout occurs.

Bullish Rectangle -

It is a bullish continuation pattern that occurs in an uptrend and signals that the price of the security will continue to trend higher on completion of the pattern.



This pattern shows that a tug of war was going on between the buyers and sellers and eventually the buyers managed to win after price gave a breakout on upside. Subsequently, buyers get aggressive and take the price even higher.

As seen in the chart on the previous page, this pattern is formed between a flat upper trend line (Resistance Line) and a flat lower trend line (Support Line).

The pattern is said to be complete only when a breakout happens on the continuation side, i.e., price breaks the resistance. This is when; a long entry is taken in the security.

It is a very powerful continuation chart pattern so if a trader has missed the uptrend earlier then he can use this opportunity to enter the security after a breakout on the higher side.

The potential target for the pattern is normally calculated projecting the height of the rectangle i.e., height between the two flat trend lines above the breakout point.

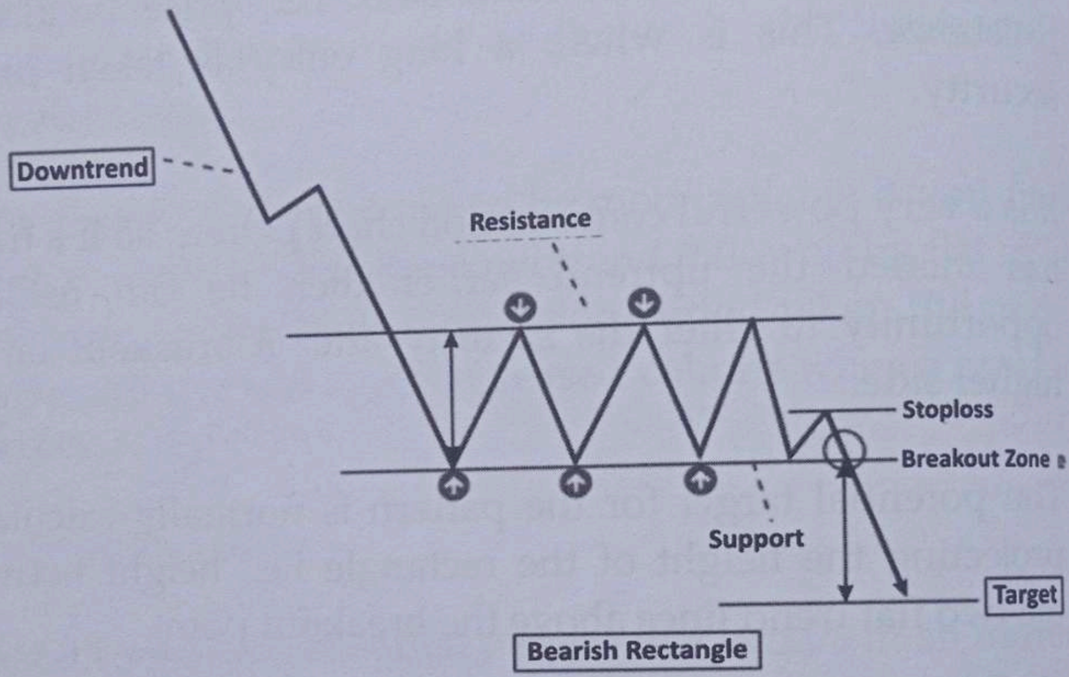
In case of this pattern, the stop loss will be placed at the swing low which occurs just before the price breaks the resistance on the upside as shown in the figure on the previous page.

The pattern is considered to be more reliable if you notice high volumes during the uptrend followed by flat or low volumes during the consolidation period when the price is in the rectangle and again increased volume when a breakout occurs.

Bearish Rectangle -

It is a bearish continuation pattern that occurs in a downtrend and signals that the price of the security will continue to trend lower on completion of the pattern.

This pattern shows that a tug of war was going on between the sellers and buyers and eventually the sellers managed to win after price gave a breakout on downside. Subsequently, sellers got aggressive and took the price even lower.



As seen in the chart above, this pattern is formed between a flat upper trend line (Resistance Line) and a flat lower trend line (Support Line).

The pattern is said to be complete only when a breakout happens on the continuation side, i.e., price breaks the support. This is when; a short entry is taken in the security.

The potential target for the pattern is normally calculated projecting the height of the rectangle i.e., height between the two flat trend lines below the breakout point.

In case of this pattern, the stop loss will be placed at the swing high which occurs just before the price breaks the support on the downside as shown in the figure above.

The pattern is considered to be more reliable if you notice high volumes during the downtrend followed by flat or low volumes during the consolidation period when the price is in the rectangle and again increased volume when a breakout occurs.

Cup and Handle –

It is a bullish continuation pattern that occurs in an uptrend and signals that the price of the security will continue to trend higher on completion of the pattern.

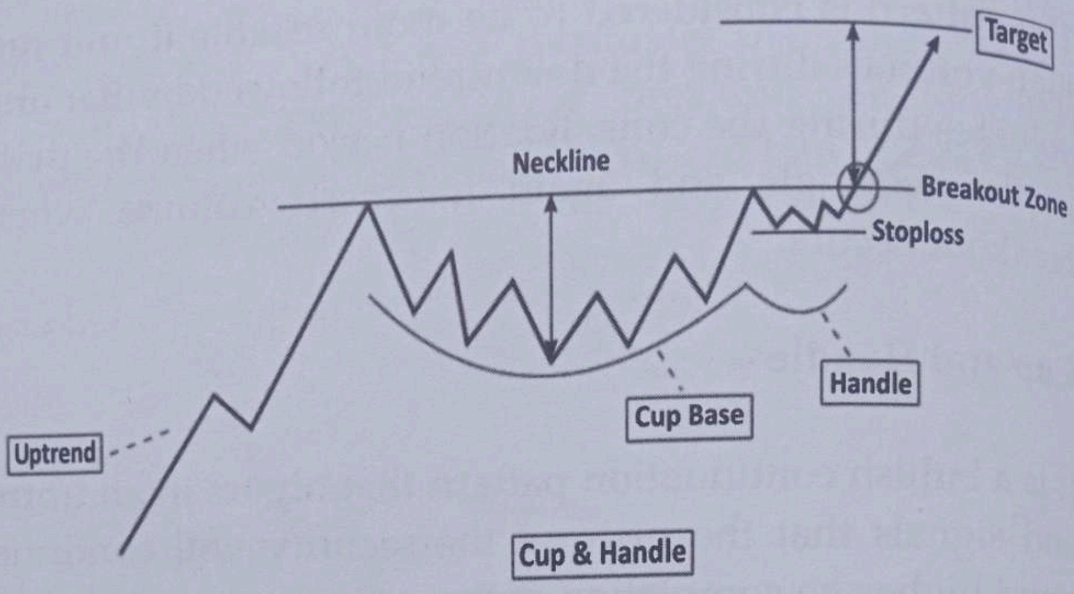
The pattern gets its name from its shape which resembles that of a conventional tea cup with a handle.

It is one of the most occurring patterns used across the world to spot dominant uptrend for taking long positions.

This pattern is characterized by a cup or a bowl shape which acts as a base for the pattern representing a period of consolidation followed by a handle that is bending on lower side representing a short pullback. A horizontal line drawn at the top of the cup is known as the neckline.

The pattern is said to be complete only when the price breaks the neckline on the upside, after formation of a handle. This is when a long entry is taken in the security.

It is a very powerful continuation chart pattern so if a trader has missed the uptrend earlier then he can use this opportunity to enter the security after a breakout on the higher side.



The potential target for the pattern is normally calculated projecting the height of the cup i.e., height between the neckline and bottom of the cup above the breakout point.

In case of this pattern, the stop loss is placed at the lowest point of the handle of the pattern as shown in the figure above.

The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks above the neckline.

Inverted Cup and Handle –

As the name indicates, it is an inverted version of the Cup and Handle Pattern explained above.

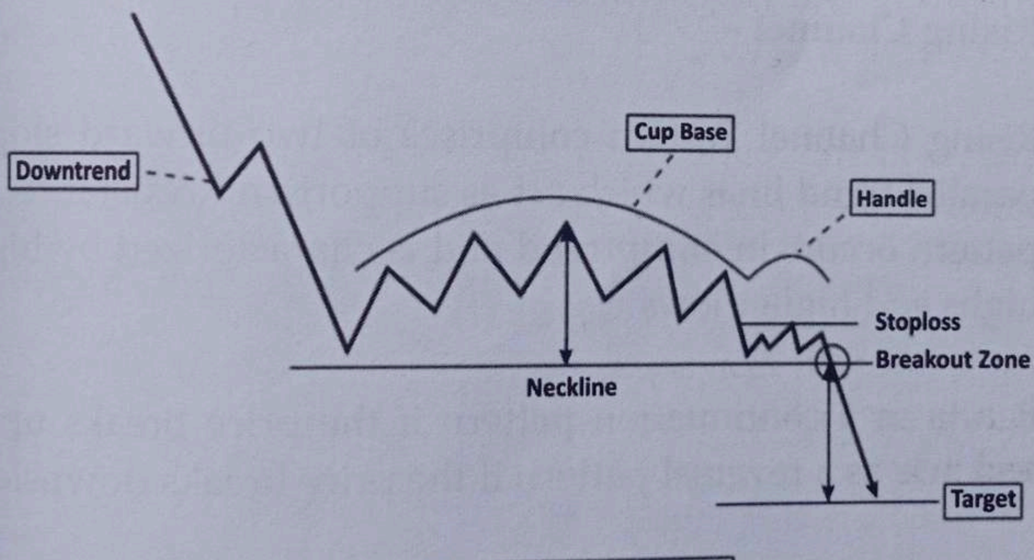
It is a bearish continuation pattern that occurs in a downtrend and signals that the price of the security will continue to trend lower on completion of the pattern.

It is one of the most occurring patterns used across the world to spot dominant downtrend for taking short positions.

This pattern is characterized by an inverted cup or a bowl shape which acts as a top for the pattern representing a period of consolidation followed by a handle that is bending higher side representing a short pullback.

A horizontal line drawn at the bottom of the inverted cup is known as the neckline.

The pattern is said to be complete only when the price breaks the neckline on the downside, after formation of a handle. This is when a short entry is taken in the security.



Inverted Cup & Handle

The potential target for the pattern is normally calculated projecting the height of the cup i.e., height between the neckline and top of the inverted cup below the breakout point.

In case of this pattern, the stop loss is placed at the highest point of the handle of the pattern as shown in the figure above.

The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks below the neckline.

Important Neutral Chart Patterns:

- Rising Channel
- Falling Channel
- Rising Wedge
- Falling Wedge
- Symmetrical Triangle

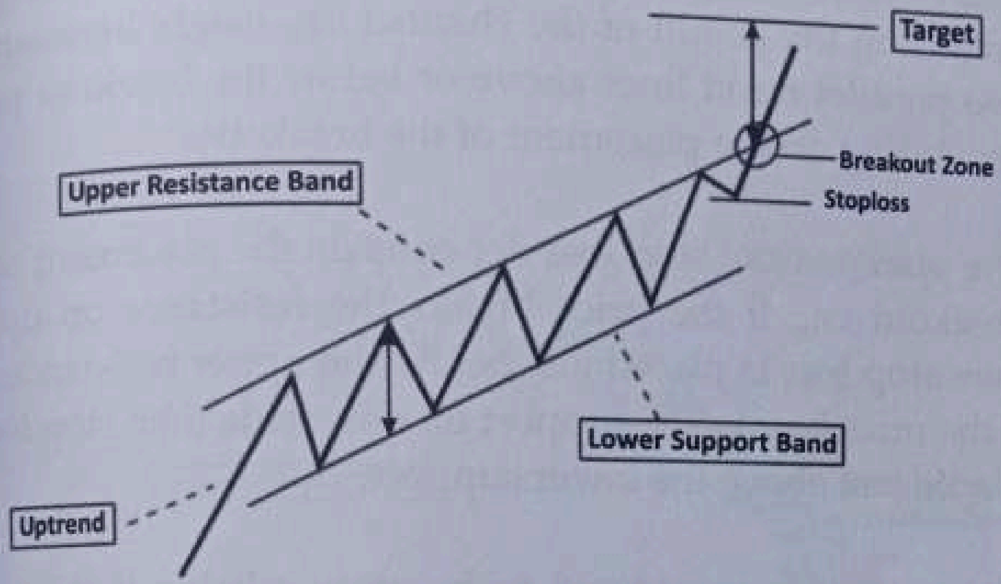
Rising Channel -

Rising Channel Pattern comprises of two upward sloping parallel trend lines which act as support and resistance. The pattern occurs in an uptrend and is characterized by higher highs and higher lows.

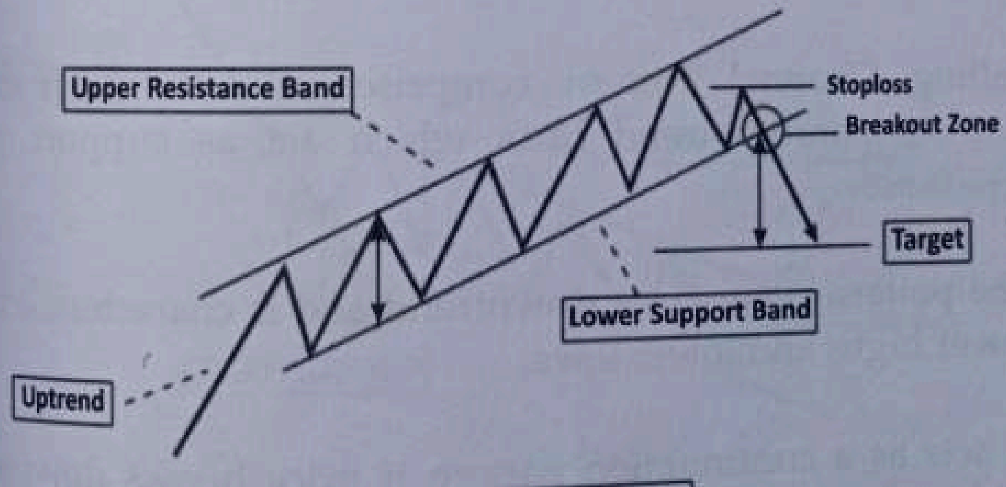
It acts as a continuation pattern if the price breaks upside and acts as a reversal pattern if the price breaks downside.

This pattern indicates that despite the price rise, a tug of war is going on between the buyers and sellers and eventually one of them wins the battle, depending on placement of the breakout.

On the next page, I have shown how the pattern works as continuation and reversal pattern.



Rising Channel Continuation



Rising Channel Reversal

In case of this pattern, traders carry out their trade depending on the placement of the breakout i.e., if the price breaks the resistance on upside then a long trade is initiated (continuation of existing uptrend) and if the price breaks the support on the downside then a short trade is initiated (reversal of existing uptrend).

The potential target for the pattern is normally calculated projecting the height of the channel i.e., height between the two parallel trend lines above or below the breakout point, depending on the placement of the breakout.

The placement of stop loss depends on the placement of the breakout i.e., if the price breaks the resistance on upside then stop loss is placed just below the upper resistance and if the price breaks the support on downside then stop loss is placed just above the lower support.

The pattern is considered to be more reliable if there is a significant rise in volume when price breaks support or resistance.

Falling Channel –

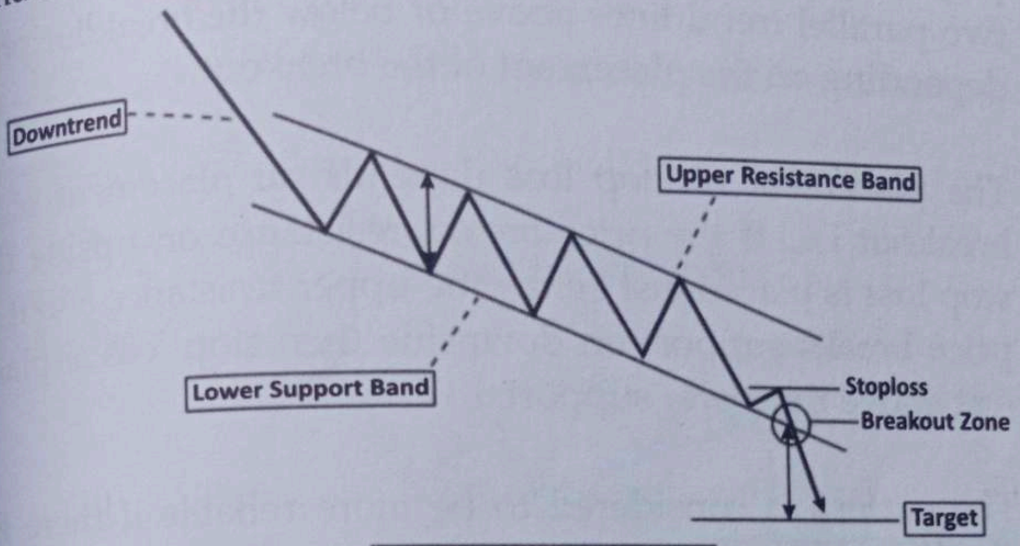
Falling Channel Pattern comprises of two downward sloping parallel trend lines which act as support and resistance.

The pattern occurs in a downtrend and is characterized by lower highs and lower lows.

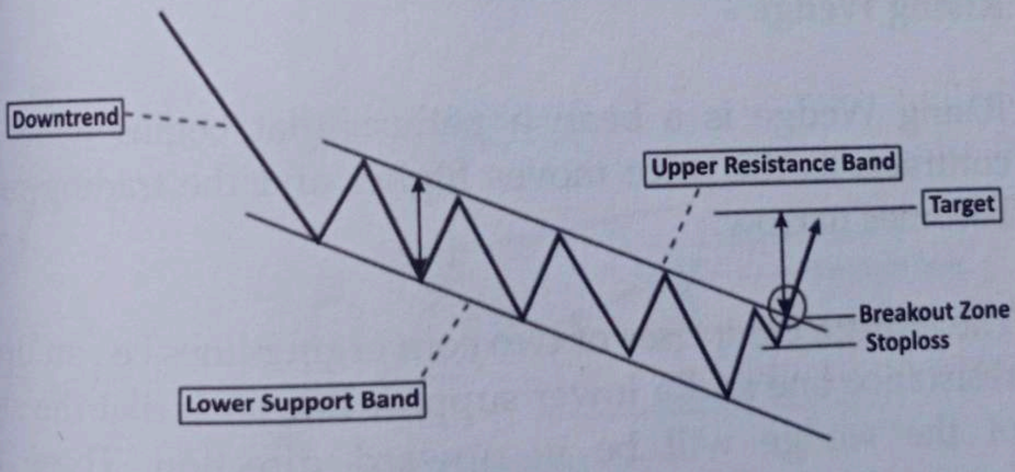
It acts as a continuation pattern if price breaks downside and acts as a reversal pattern if price breaks upside.

This pattern indicates that despite the price fall, a tug of war is going on between the sellers and buyers and eventually one of them wins the battle, depending on placement of the breakout.

Below I have shown how the pattern works as continuation and reversal pattern.



Falling Channel Continuation



Falling Channel Reversal

In case of this pattern, traders carry out their trade depending on the placement of the breakout i.e., if the price breaks the resistance on upside then a long trade is initiated (reversal of existing downtrend) and if the price breaks the support on downside then a short trade is initiated (continuation of existing downtrend).

The potential target for the pattern is normally calculated projecting the height of the channel i.e., height between the two parallel trend lines above or below the breakout point, depending on the placement of the breakout.

The placement of stop loss depends on placement of the breakout i.e., if the price breaks resistance on upside then stop loss is placed just below the upper resistance and if the price breaks support on downside then stop loss is placed just above the lower support.

The pattern is considered to be more reliable if there is a significant rise in volume when price breaks support or resistance.

Rising Wedge –

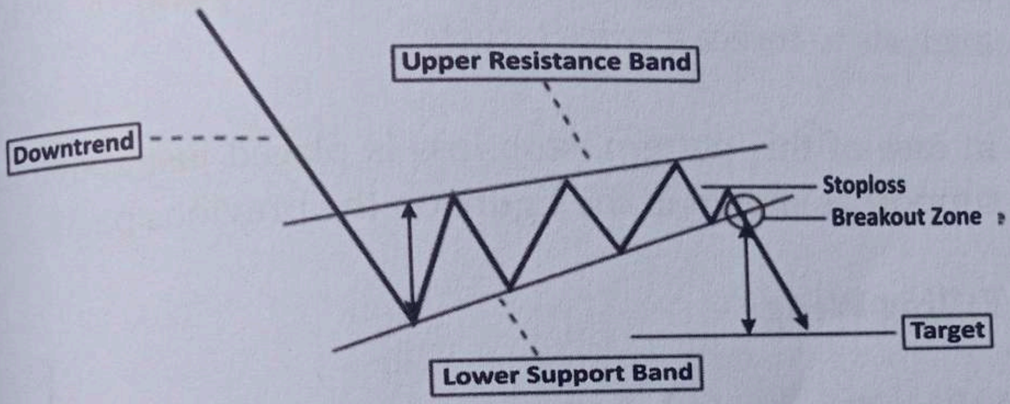
Rising Wedge is a bearish pattern that begins wide and contracts as the price moves higher and the trading range becomes narrow.

The pattern comprises of two converging lines i.e., an upper resistance line and a lower support line such that the slope of the wedge will be in upward direction. These two converging lines signal that bullishness within the pattern is decreasing.

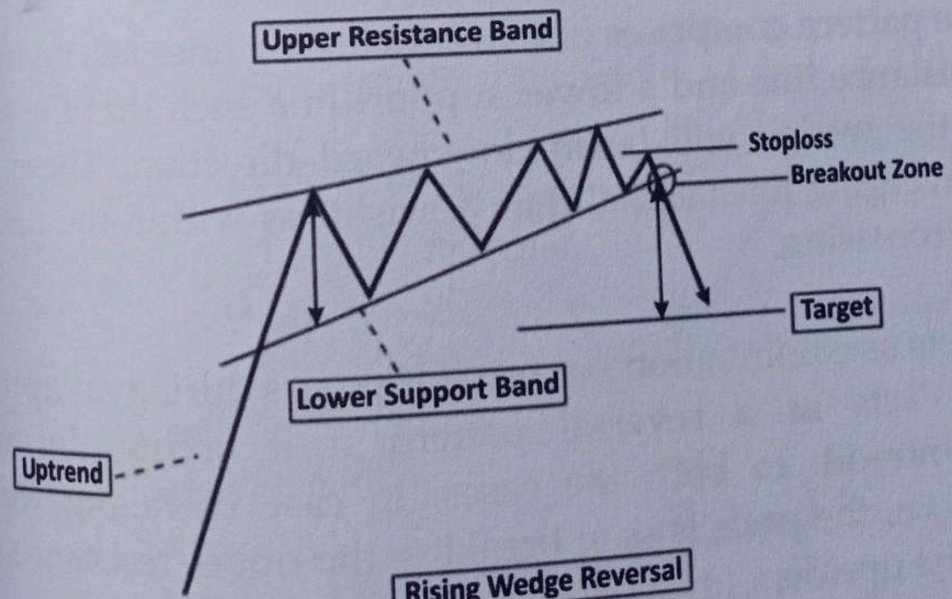
It acts as a continuation pattern if it occurs during a downtrend and acts as a reversal pattern if it occurs during an uptrend. In both the cases, in case of rising wedge pattern, the price is seen breaking the lower support line on the downside.

This pattern indicates that despite the price rise inside the wedge, a tug of war is going on between the buyers and sellers and eventually the sellers win the battle.

Below I have shown how the pattern works as continuation and reversal pattern.



Rising Wedge Continuation



Rising Wedge Reversal

The pattern is said to be complete only when the price breaks the lower support line on the downside. This is when a short entry is taken in the security.

The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks below the lower support line.

In case of this pattern, there is no target measuring technique and hence it is advised to use a trailing stop loss in case of this pattern or use other aspects of technical analysis to forecast price targets.

In case of this pattern, stop loss is placed just above lower support as shown in the figure on the previous page.

Falling Wedge –

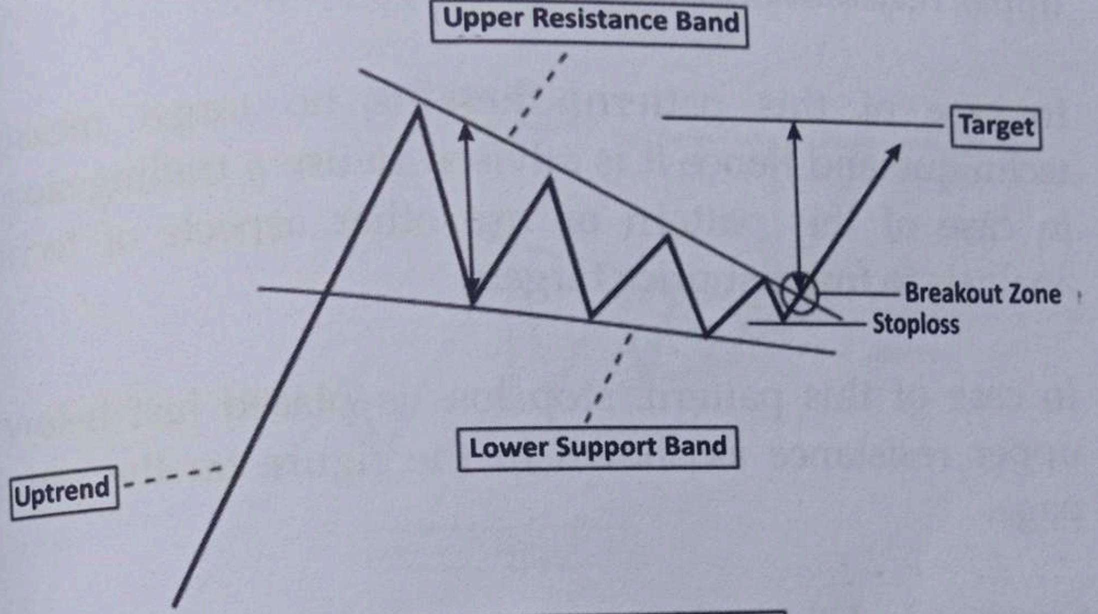
Falling Wedge is a bullish pattern that begins wide and contracts as the price moves lower and the trading range becomes narrow.

The pattern comprises of two converging lines i.e., an upper resistance line and a lower support line such that the slope of the wedge will be in downward direction. These two converging lines signal that bearishness within the pattern is decreasing.

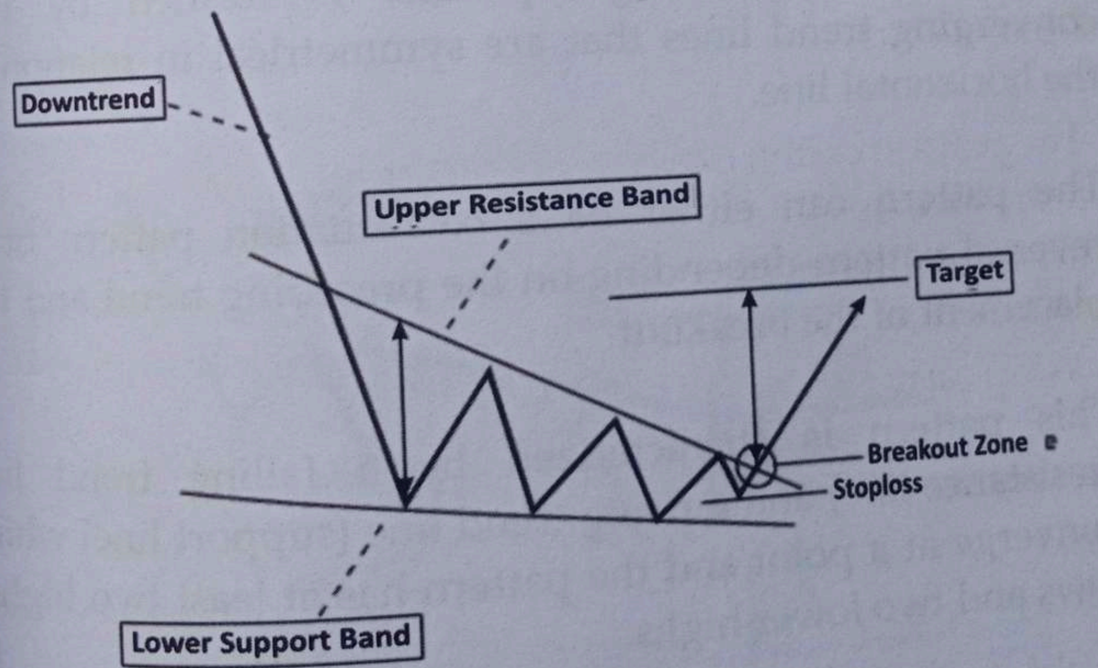
It acts as continuation pattern if it occurs during an uptrend and acts as a reversal pattern if it occurs during a downtrend. In both the cases, in case of falling wedge pattern, the price is seen breaking the upper resistance line on the upside.

This pattern indicates that despite the fall in price inside the wedge, a tug of war is going on between the sellers and buyers and eventually the buyers win the battle.

Below I have shown how the pattern works as continuation and reversal pattern.



Falling Wedge Continuation



Falling Wedge Reversal

The pattern is said to be complete only when the price breaks the upper resistance line on the upside. This is when a long entry is taken in the security.

The pattern is considered to be more reliable if there is a significant rise in volume when the price breaks above the upper resistance line.

In case of this pattern, there is no target measuring technique and hence it is advised to use a trailing stop loss in case of this pattern or use other aspects of technical analysis to forecast price targets.

In case of this pattern, stop loss is placed just below the upper resistance as shown in the figure on the previous page.

Symmetrical Triangle –

The symmetrical triangle pattern is formed by two converging trend lines that are symmetrical in relation to the horizontal line.

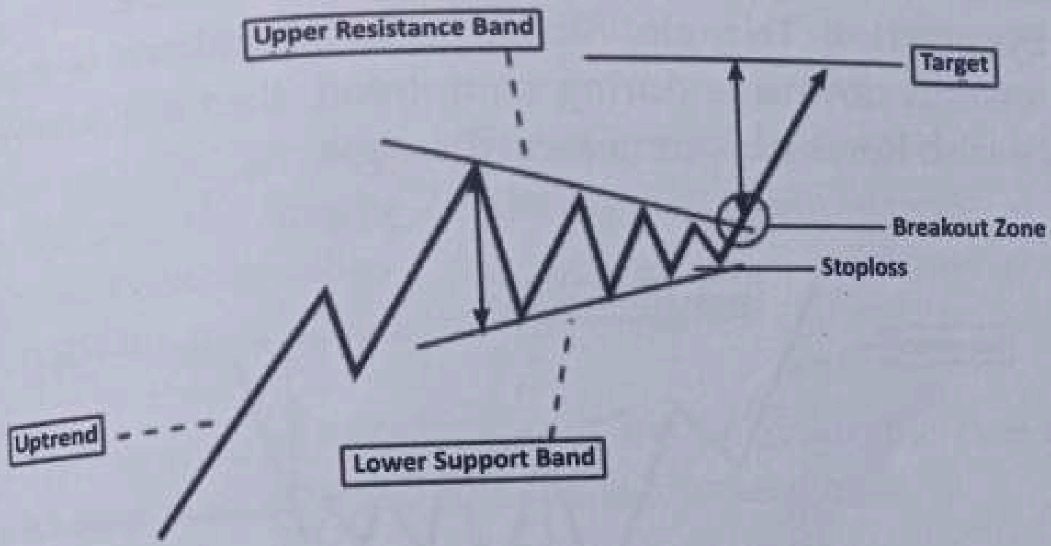
The pattern can either be a continuation pattern or a reversal pattern depending on the preceding trend and the placement of the breakout.

This pattern is characterized by a falling trend line (resistance line) and a rising trend line (support line) which converge at a point and the pattern has at least two higher lows and two lower highs.

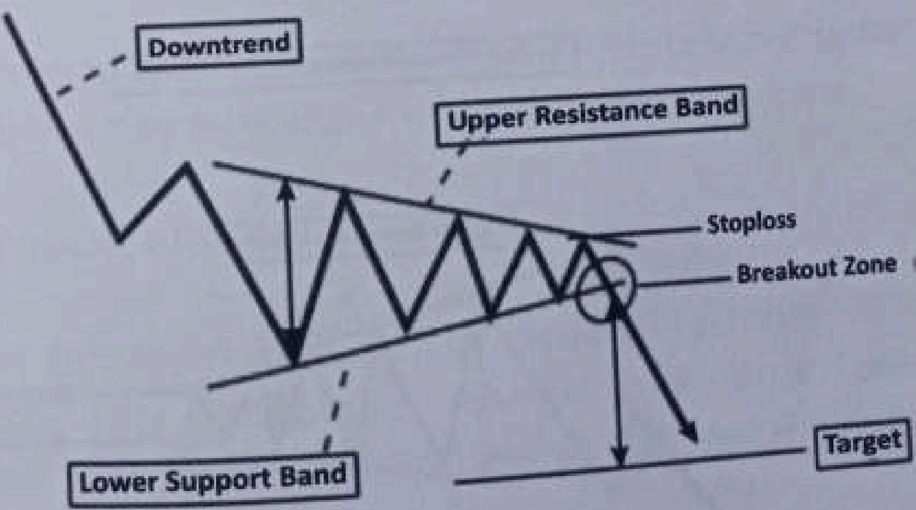
Symmetrical Triangle as a Continuation Pattern –

If the pattern is broken towards upside during an uptrend, then it is known as Bullish Continuation Symmetrical Triangle.

Similarly, if the pattern is broken towards downside during a downtrend, then it is known as Bearish Continuation Symmetrical Triangle.



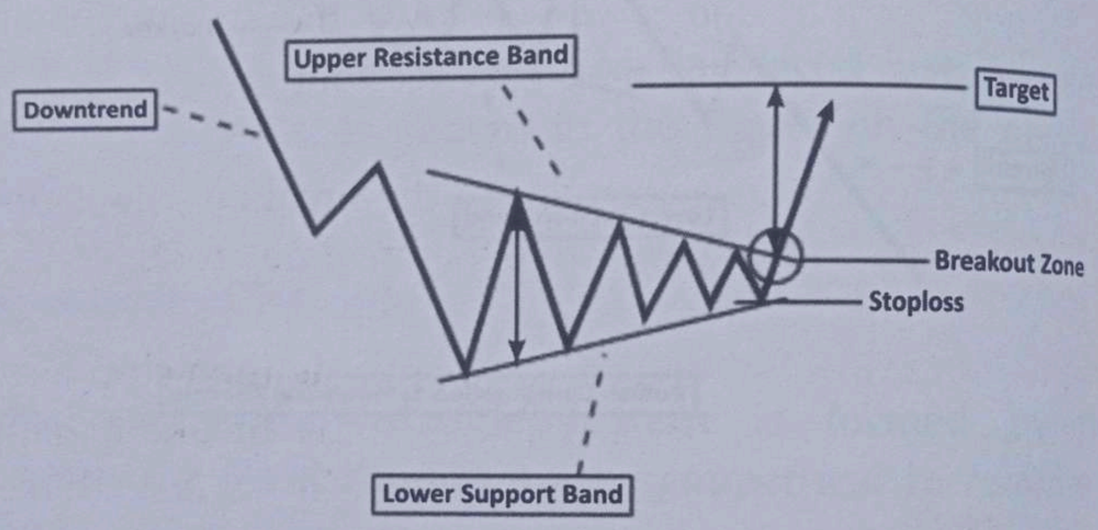
Bullish Continuation Symmetrical Triangle



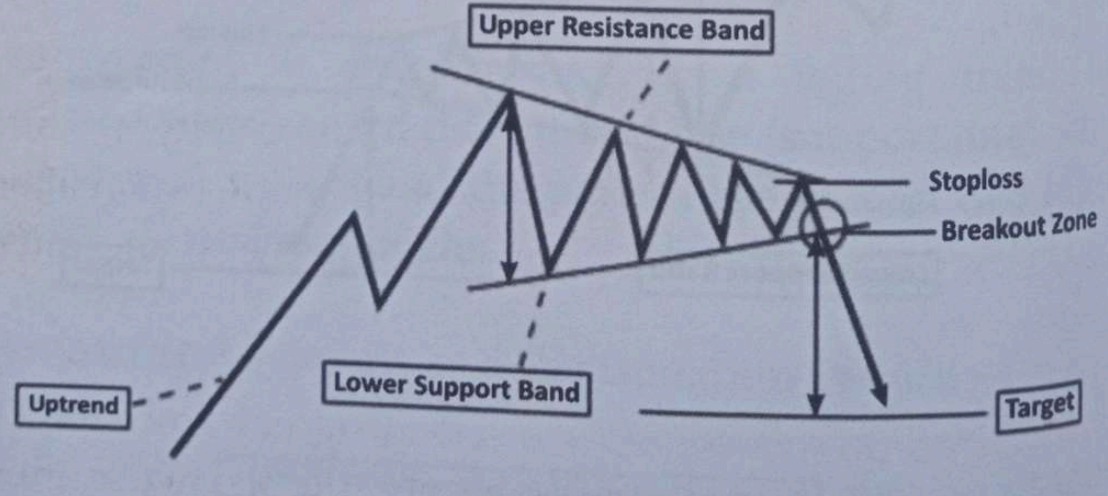
Bearish Continuation Symmetrical Triangle

Symmetrical Triangle as a Reversal Pattern –

If the pattern is broken towards upside during a downtrend, then it is known as Bullish Reversal Symmetrical Triangle. Similarly, if the pattern is broken towards downside during an uptrend, then it is known as Bearish Reversal Symmetrical Triangle.



Bullish Reversal Symmetrical Triangle



Bearish Reversal Symmetrical Triangle

In case of Symmetrical Triangle Pattern, traders carry out their trade depending on the placement of the breakout i.e., if the price breaks the resistance on upside then a long trade is initiated and if the price breaks the support on downside then a short trade is initiated.

The potential target for the pattern is normally calculated projecting the height of the symmetrical triangle at its thickest point above or below the breakout point, depending on placement of the breakout.

Depending on the placement of the breakout, the stop loss will be placed below or above the breakout zone.

If the breakout happens towards upside then stop loss will be just below the breakout and if the breakout happens towards downside then stop loss will be just above the breakout as shown in images on the previous page.

The pattern is considered to be more reliable if there is a significant rise in volume when a breakout occurs.

The Bottom Line :

Never forget to look at the volume activity to confirm whether the breakout is real or fake. Real breakout is always associated with increased volume at the breakout zone.

I would request everyone to spend decent amount of time spotting all these patterns on charts and practice as much as you can to become good at reading these chart patterns.

VOLUME ANALYSIS

Volume refers to the number of transactions that took place in a given security during a given period of time.

Volume is an important parameter which is used by most of the technical analyst in analyzing securities. By analyzing trends in volume in conjunction with price movements, investors can determine the significance of changes in a security's price.

Most of the intraday traders as well as swing traders make use of volume to see the strength of the prevailing trend.

One thing I have commonly observed among beginners and people who are suffering losses in their trading is that they often don't analyze volume. According to my understanding interpreting volume will bring many advantages to traders and it will help them gain an edge over others.

There is a famous quote that relates to Price Volume Correlation which goes like this,

"Price is the King, but Volume is the Queen."

Yes, you read it right, so if you are trading and using technical analysis then while monitoring a security for an entry point don't just look at the price action, keep an eye on volume as well, to make predictions about future price movements.

Many times, high volumes of trading can infer a lot about an investor's outlook about a security or market.

The table below shows interpretation of rising or falling volumes with rising and falling prices of security.

Price	Volume	Significance
» Rising Price	Rising Volume	Very Strong Bullish Momentum
» Rising Price	Falling Volume	Unreliable Bullish Momentum
» Falling Price	Rising Volume	Very Strong Bearish Momentum
» Falling Price	Falling Volume	Unreliable Bearish Momentum

A significant price increase along with a significant increase in volume is often considered as a credible or very strong sign of a continued bullish trend or a bullish reversal. However, if the price is moving higher with low volumes, then it is considered to be unreliable.

Similarly, a significant price decrease with a significant increase in volume is often considered as a credible or very strong sign of a continued bearish trend or a bearish reversal. However, if the price is going down with low volumes, then it is considered to be unreliable.

Apart from this, in trading volume can be used in many other aspects, some of which are like –

- Liquidity
- Confirming Respect of Support and Resistance
- Confirming Breakout of Support and Resistance
- Confirming Reversal Chart Pattern Breakout
- Confirming Continuation Chart Pattern Breakout

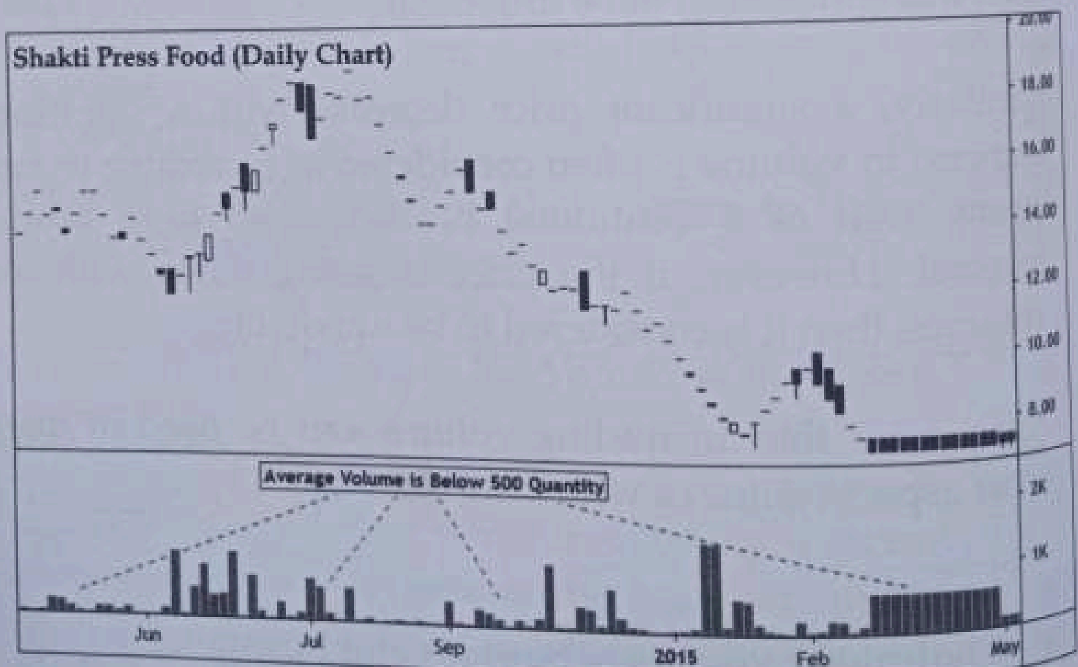
Liquidity -

Volume is an important indicator of liquidity in any security. A security having very low trading volume will indicate that nobody or very few market participants are interested in buying or selling that security.

Technical Analysis does not work in case of such securities. Another fact is, it is easy to manipulate the price action of such illiquid securities. If you buy a security which is having very little volume, then you might get stuck in it, being unable to sell it due to its illiquid nature.

Therefore, it is very important to check and analyze the volume of any security before trading in it.

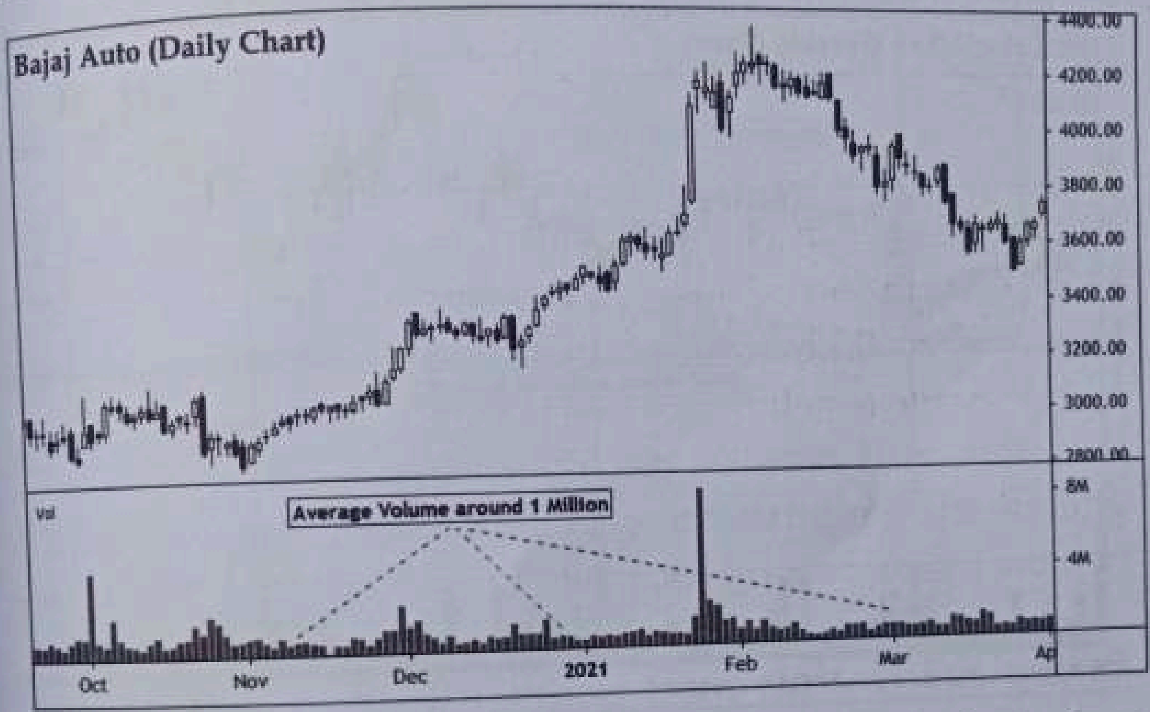
Example : Low Volume Stock



Above you can see the daily chart of Shakti Press Food from March 2014 to June 2015. The average daily volume of the stock was 500 which is a clear indication that the stock is illiquid and should be avoided for trading or investing.

You can also notice that on most of the trading days, the stock was either in upper circuit or in lower circuit.

Example : High Volume Stock



Above you can see the daily chart of Bajaj Auto from December 2020 to March 2021. The average daily volume of the stock was over 1.0M (above 10,00,000) which is a clear indication that this stock is having good volume and such stocks should be used for trading as well investing purpose.

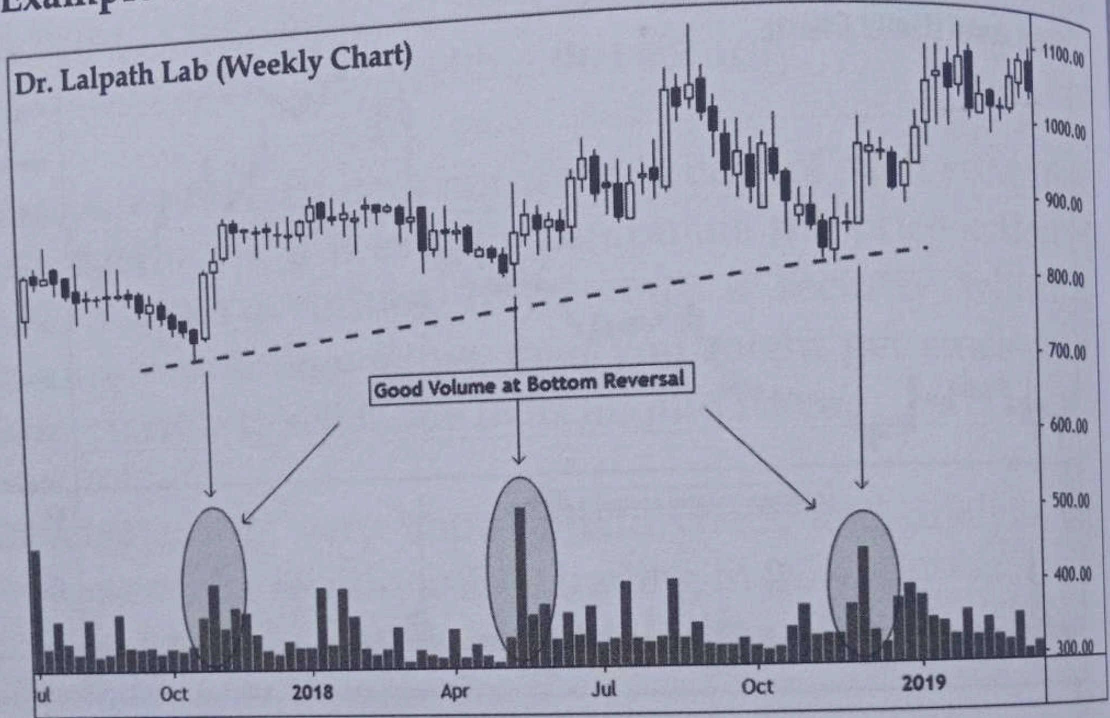
Confirming Respect of Support and Resistance –

Volume is an important indicator that can often confirm whether a security will take support or face resistance at a particular level.

When the price of a security is approaching towards a support or resistance the average volume is lesser as compared to when it reaches very near to the support or resistance.

The examples shown below shall explain this concept in a better manner.

Example : Price Taking Support at Trendline



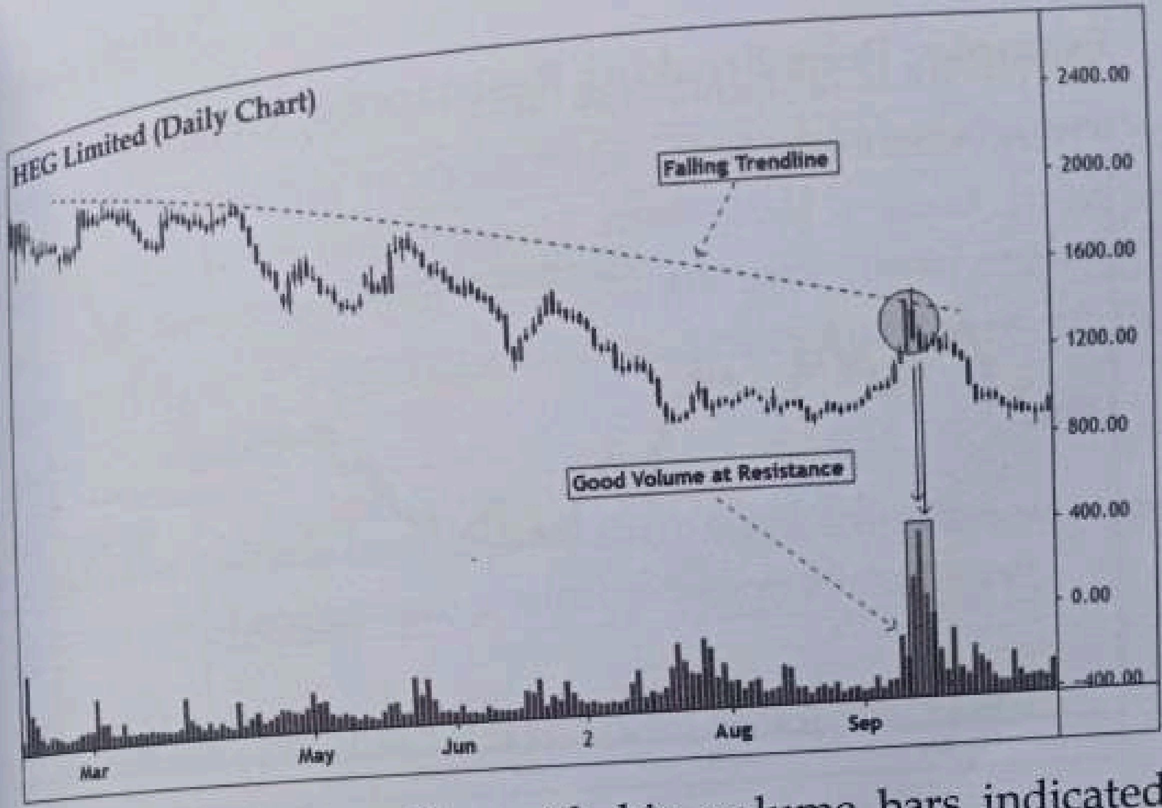
Above you can see the weekly chart of Dr. Lalpath Lab from July 2017 to January 2019. On three occasions as circled you can see increased volume action when price took support at the rising support trendline.

Here watchout for price rise with increased volume.

Now after getting confirmation from volume, traders could have taken a buying position at those price points.

Example : Price Facing Resistance at Trendline

On the next the page you can see the daily chart of HEG Limited from February 2019 to October 2019. You can see how the stock price faced resistance at the falling resistance trendline with increased volume.



The two bearish candles with big volume bars indicated that there was extreme selling pressure at the falling resistance trend line.

Now after getting confirmation from the volume, traders could have taken a short position at that level.

Confirming Breakout of Support and Resistance –

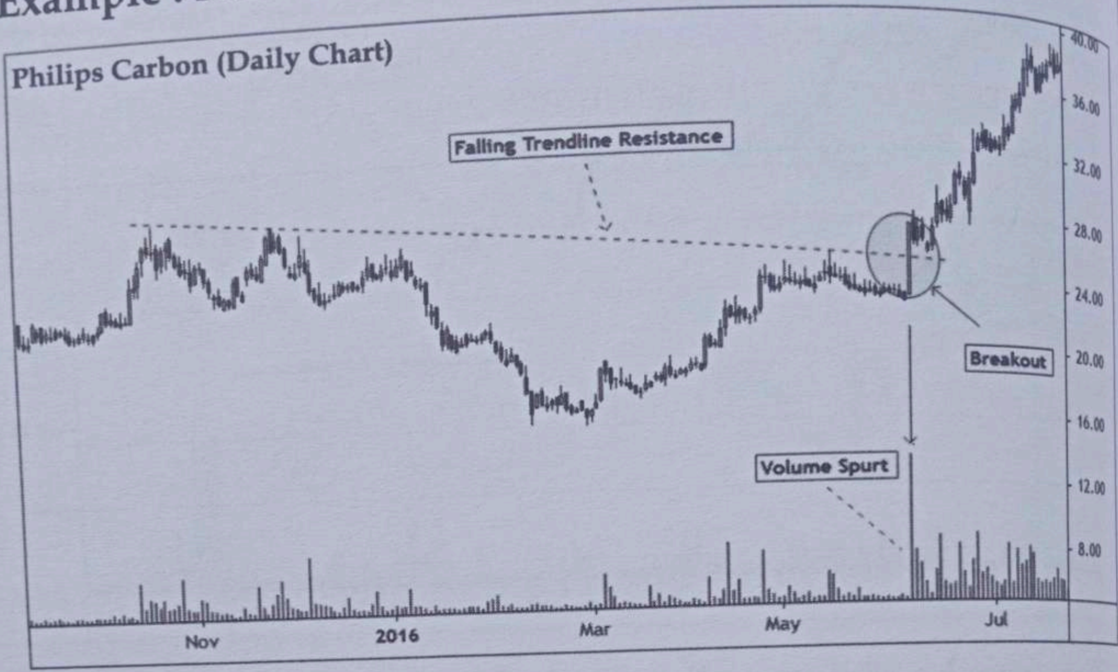
Volume is an important indicator that can often confirm whether a security has given a valid breakout or a false breakout from a support or resistance trendline.

A valid or genuine breakout occurs on high volumes while a false breakout occurs on low volumes.

Hence in case of a breakout, it is very important to look at volumes.

The examples shown ahead shall explain this concept in a better manner.

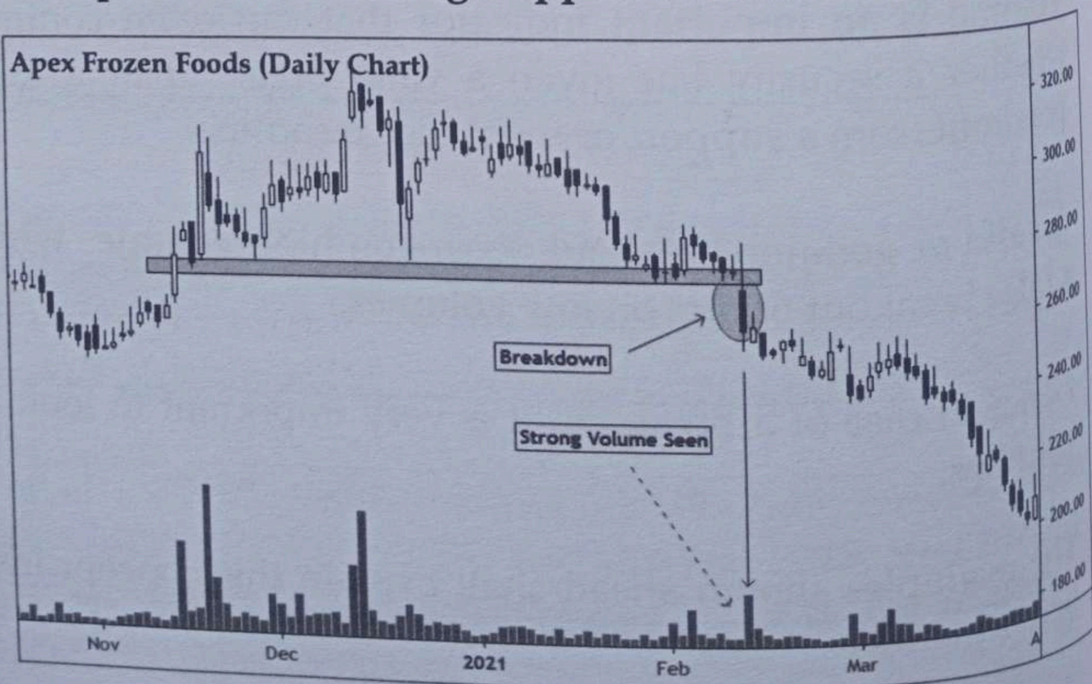
Example : Price Breaking Resistance at Trendline



Above you can see the daily chart of Phillip Carbon from September 2015 to July 2016. The stock price broke falling resistance trendline with huge volume indicating that there was extreme buying pressure at falling trendline resistance.

Now after getting breakout confirmation from the volume, traders could have taken a long position at that level.

Example : Price Breaking Support at Trendline



On the previous page, you can see the daily chart of Apex Frozen Foods from October 2020 to March 2021. The stock price broke the support zone with a good spurt in volume indicating that it is a genuine breakout. This indicates that there was extreme selling pressure at the support zone.

Now after getting breakout confirmation from the volume, traders could have taken a short position at that level.

Confirming Reversal Chart Pattern Breakout –

It is important to analyse volume when breakout occurs in case of reversal chart patterns. This point has been explained earlier in the chapter of Chart Patterns while explaining popular Reversal Chart Patterns.

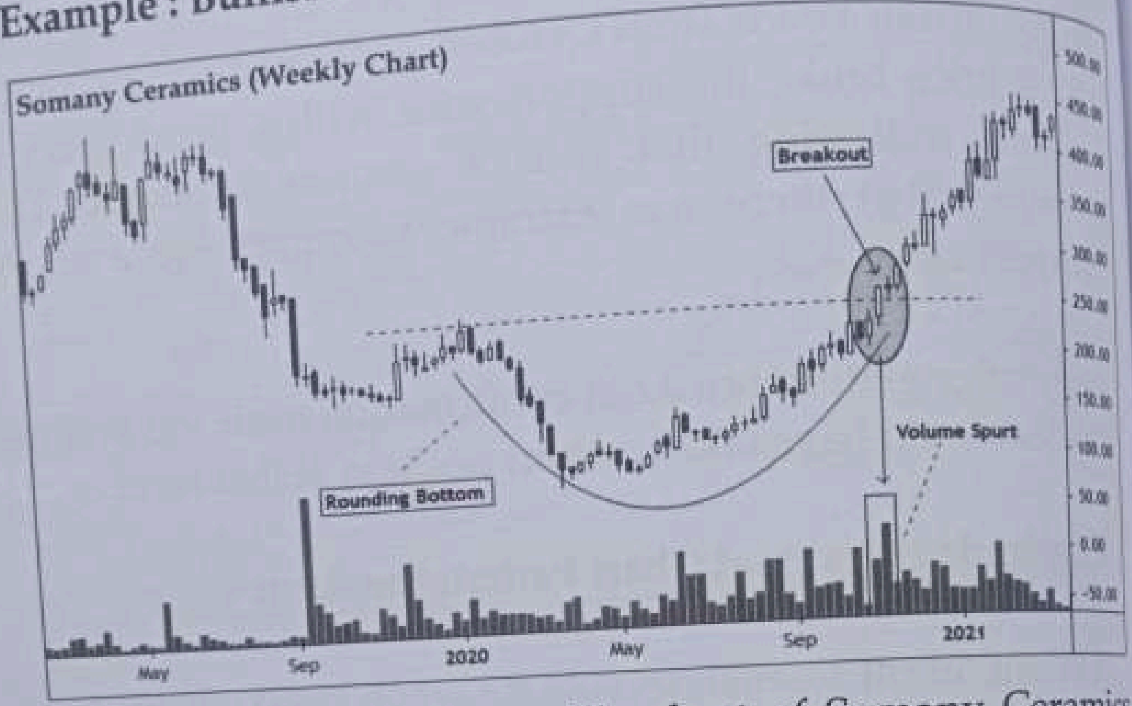
Whenever a security's price gives a breakout after forming a chart pattern, it is important to check the volume to determine the strength of the breakout.

In case of bullish reversal patterns, if a price breakout occurs with strong volume then it can safely be assumed that upcoming uptrend will be very strong.

Similarly, in case of bearish reversal patterns, if a price breakout occurs with strong volume then it can safely be assumed that upcoming downtrend will be very strong.

For better clarity, I am explaining the same with the help of a few examples.

Example : Bullish Reversal Chart Pattern Breakout



Above you can see the weekly chart of Somany Ceramics from February 2019 to March 2021 forming a rounding bottom pattern. The price broke the pattern neckline with a good spurt in volume which indicated end of current downtrend and a strong reversal was about to happen.

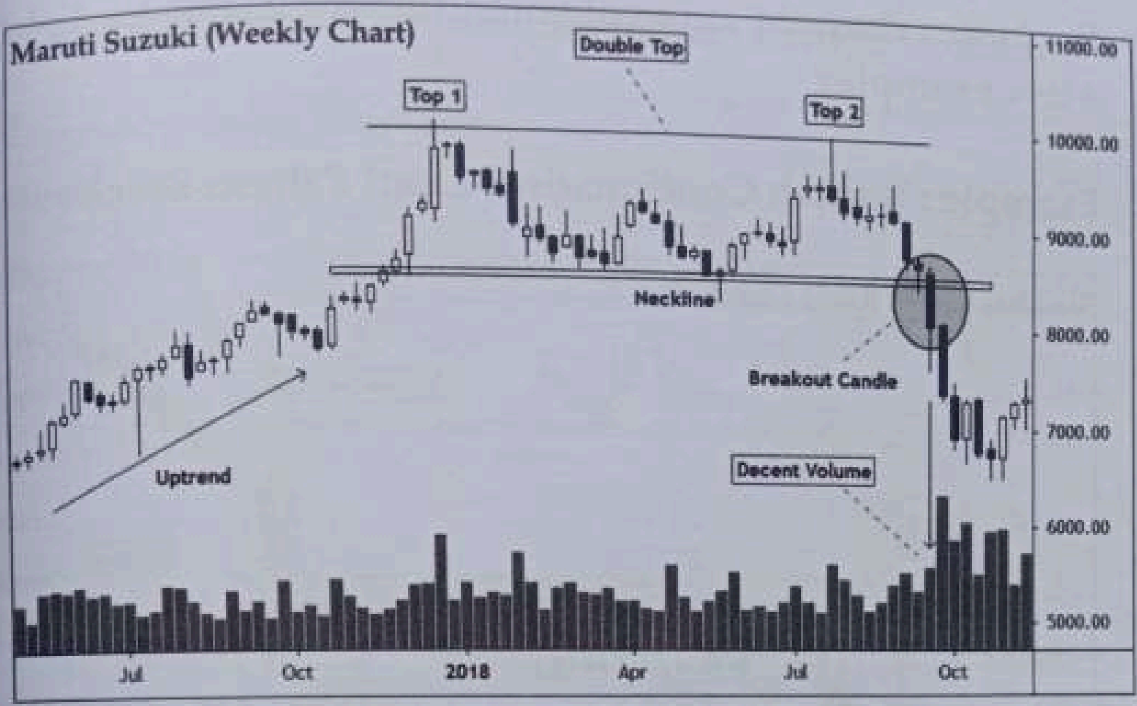
Now after getting breakout confirmation from volume, traders could have taken a long position at that level.

Example : Bearish Reversal Chart Pattern Breakout

On the next page, you can see the weekly chart of Maruti Suzuki from June 2017 to October 2018 which formed a double top pattern.

Price broke the pattern neckline with a good spurt in volume around 8458 level which indicated end of current uptrend and a strong reversal was about to happen.

Now after getting breakout confirmation from the volume, traders could have taken a short position at that level.



As you can see in the above chart, after the breakdown happened a decent downside was seen.

Confirming Continuation Chart Pattern Breakout -

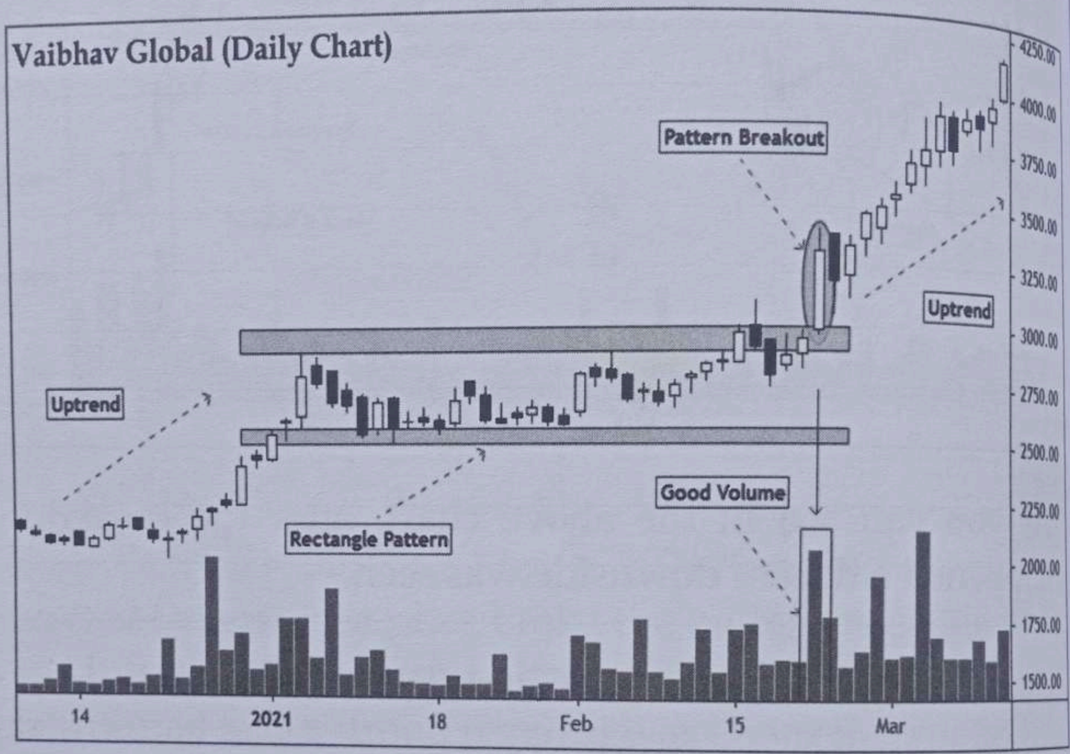
It is important to analyze volume when a breakout occurs in case of continuation chart patterns as well. This point has been explained earlier in the chapter of Chart Patterns while explaining popular Continuation Chart Patterns.

Whenever a security's price gives a breakout after forming a chart pattern, it is important to check the volume to determine the strength of the breakout.

In case of bullish continuation patterns, if a price breakout occurs with strong volume then it can safely be assumed that ongoing uptrend will continue further. Similarly, in case of bearish continuation patterns, if a price breakout occurs with strong volume then it can safely be assumed that ongoing downtrend will continue further.

For better clarity, I am explaining the same with the help of a few examples.

Example : Bullish Continuation Chart Pattern Breakout

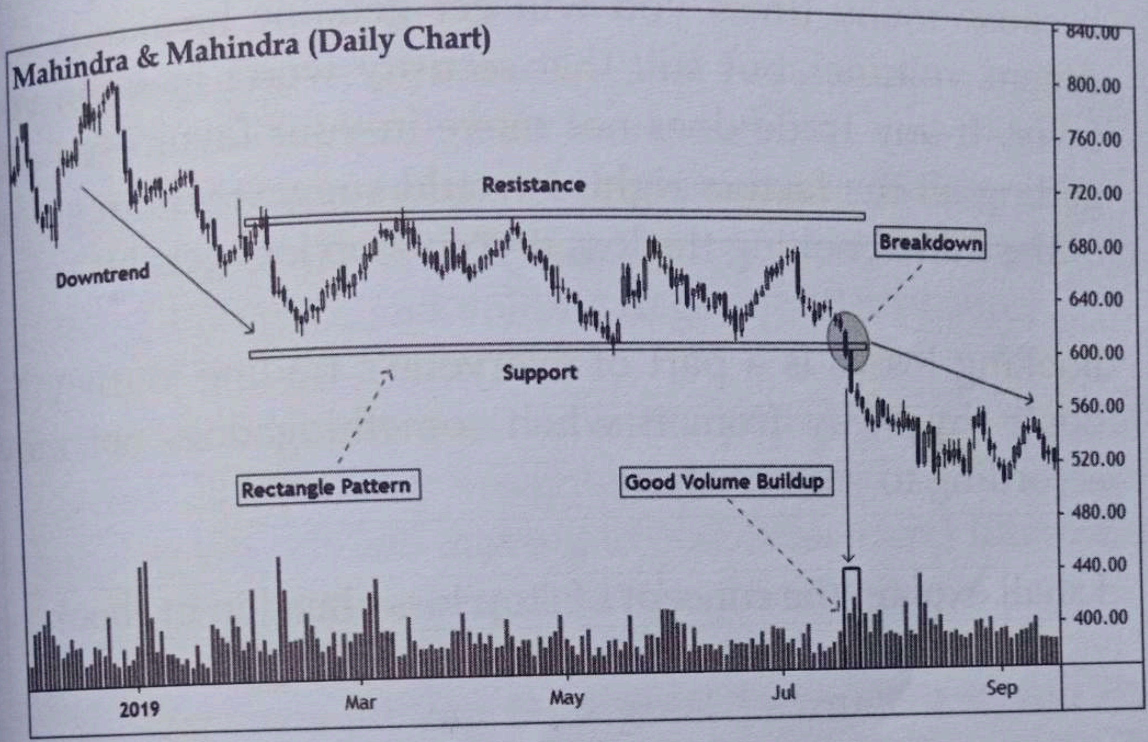


Above you can see the daily chart of Vaibhav Global from December 2020 to March 2021 forming a rectangle pattern in between an uptrend. Later on, the price gave a breakout on upside with very good volume to indicate that the uptrend is still intact and the price will continue to rise further.

Now after getting breakout confirmation from the volume, traders could have taken a long position at that point.

One can also note a false breakout attempt a few days ago on lower volumes. This further signifies the importance of volume analysis.

Example : Bearish Continuation Chart Pattern Breakout



Above you can see the daily chart of Mahindra & Mahindra from November 2018 to September 2019 forming a rectangle pattern in between a downtrend. Later on, the price gave a breakout on downside with very good volume to indicate that the downtrend is still intact and the price will continue to go down further.

Now after getting breakout confirmation from the volume, traders could have taken a short position at that point.

Bottom Line :

It is always important for a trader or investor to keep in mind that volume alone will not be sufficient for taking a trading position. One has to use it as a secondary confirmation indicator in conjunction with price patterns and other price action parameters to increase the likelihood of being right and getting that trade in your favor.

Don't just blindly look at volume and take your position because many times you will get genuine breakouts with decent volumes but still that security won't move in your favor. If any trade does not move in your favor even after getting all the factors right, I would suggest you to get out of the trade booking the loss if your stop loss gets hit.

Booking losses is a part of everyone's trading journey. So, don't shy away from it when something does not move according to your analysis.

I shall explain the concept of stop loss ahead in the book.

USING MOVING AVERAGE

Theoretically, when we talk about Price Action Trading, we don't use Technical Indicators and we base our trading decision entirely on the price behavior of the security. But in reality, I shall advise traders to use moving average along with price and volume to get a better picture.

Moving averages are the most popular tools but never forget that primary weightage is to be given to the price action. We can use moving averages for trend filtering and smoothing out the noise from the price action.

Moving averages can be a great instrument if you know which one to use when. In this chapter, I shall explain about most effective and widely used moving averages which have a great significance in price action trading.

Moving Average:

Moving average is a simple technical analysis tool that smooths out price data by creating a constantly updated average price. The average is taken over a specific period of time which can be in minutes, days, weeks or months depending on the choice of the trader.

Moving averages do not predict the price direction but rather they define the prevailing direction. It is a trend based indicator that is used to determine the direction of the trend.

A moving average helps cut down the amount of "noise" on a price chart. Look at the direction of moving average to get a basic idea about which way the price is moving.

Types of Moving Averages -

There are two types of moving averages - Simple and Exponential.

Simple Moving Average - A simple moving average is an arithmetic moving average calculated by adding recent prices and then dividing the sum by the number of time periods in the calculation of the average.

Exponential Moving Average - This moving average gives more weightage to the recent data points and hence it is more responsive than simple moving average.

I will not get into the calculation part as I don't want you to get confused if you are a beginner. You can easily select the required moving average and apply it on any chart on any charting website.

I would not say this is the best or worse time period in case of moving average; rather I will discuss time periods used in moving average by most of the traders across the world and will also explain to you how to use them practically on charts.

You can start using moving average and see what works for you and stick to it as long as it gives you favorable results.

Uses of Moving Average -

Moving averages are widely used for determining support and resistance; generate trading signals as well as used for placement of stop loss.

1. Determining Support or Resistance

A moving average can be used as support or resistance.

In an uptrend, a 50-day, 100-day or 200-day moving average may act as a support level, as shown in the examples below.

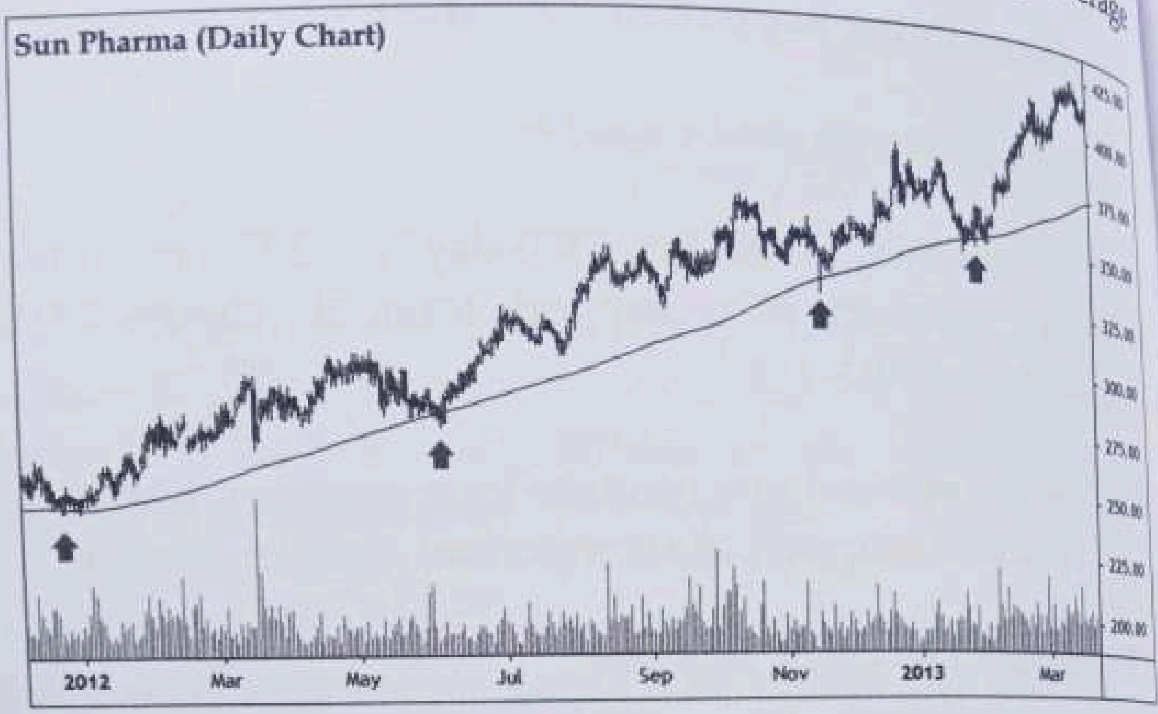
During an uptrend you can take long positions whenever a security takes support at an important moving average.

Example 1 : 50 DMA Support

The image below shows the daily chart of Infosys from June 2020 to February 2021 where you can see price is clearly taking support from its 50 day moving average.

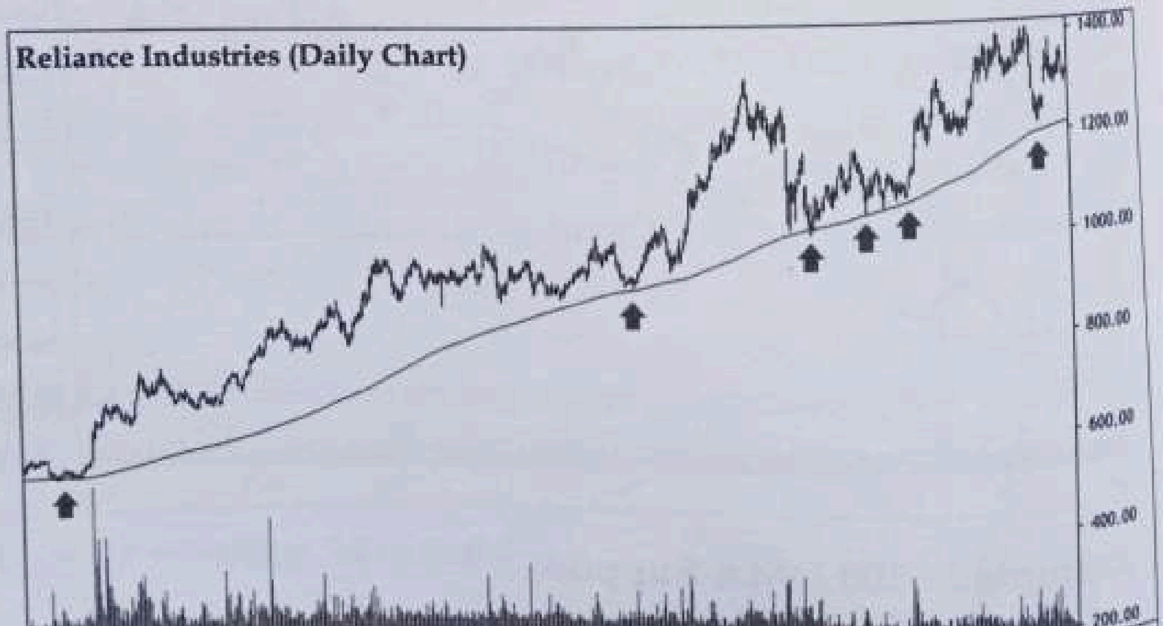
Example 2 : 100 DMA Support

The image on the next page shows the daily chart of Sun Pharmaceutical from January 2012 to March 2013 where you can see price is clearly taking support from its 100 day moving average.



Example 3 : 200 DMA Support

The image below shows the daily chart of Reliance Industries from January 2016 to June 2019 where you can see price is clearly taking support from its 200 day moving average.

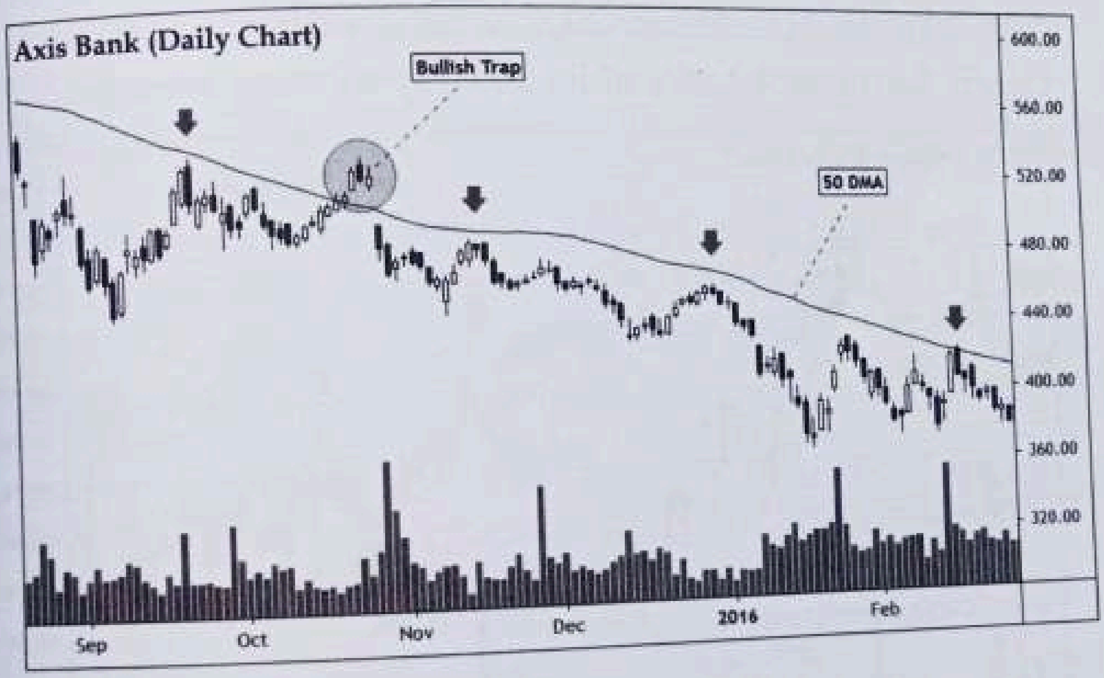


In a downtrend, a 50-day, 100-day or 200-day moving average may act as a resistance level, as shown in the examples ahead.

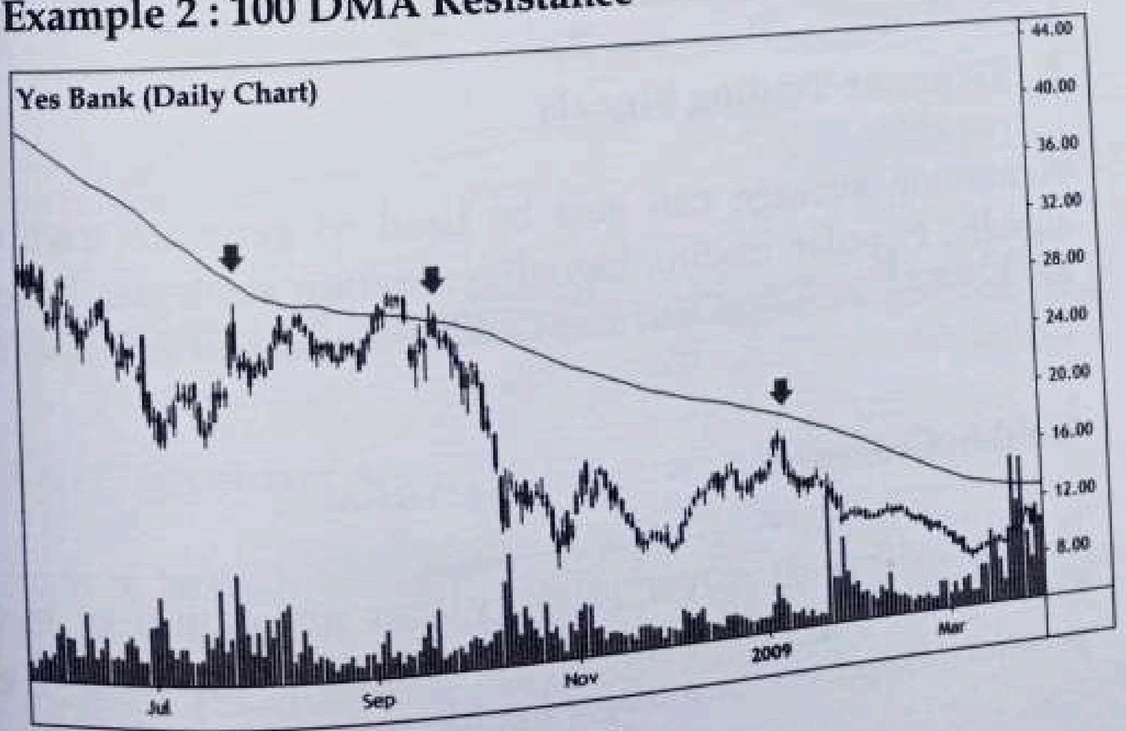
During a downtrend you can take short positions whenever a security faces resistance at an important moving average.

Example 1 : 50 DMA Resistance

The image below shows the daily chart of Axis Bank from August 2015 to February 2016 where you can see price is clearly facing resistance at its 50 day moving average.



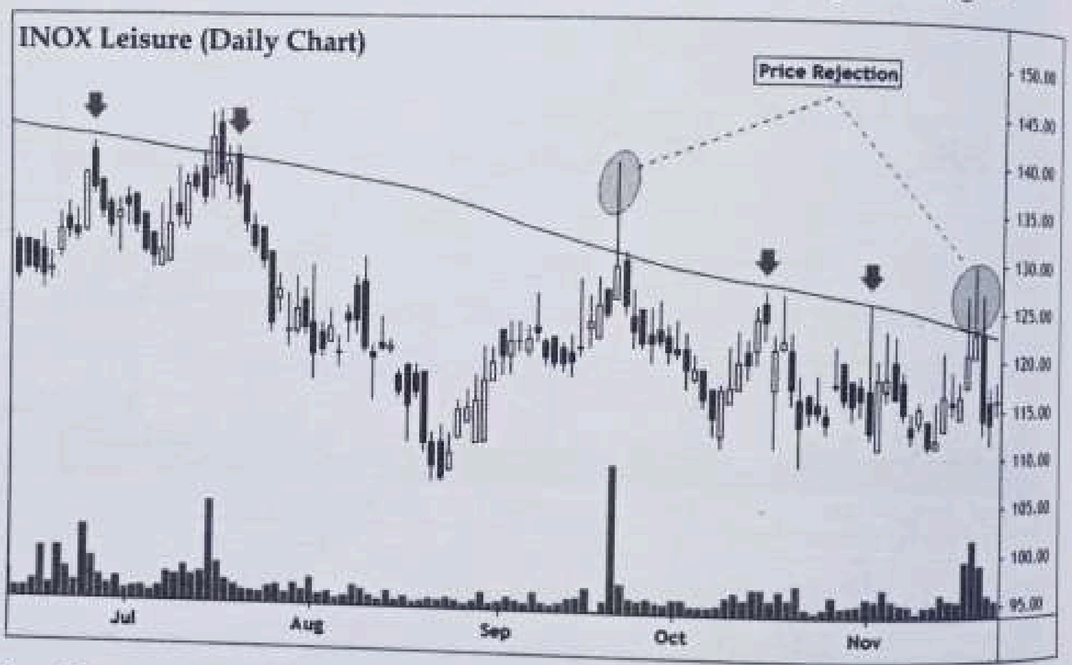
Example 2 : 100 DMA Resistance



The image on the previous page shows the daily chart of Yes Bank from May 2008 to April 2009 where you can see price is clearly facing resistance at its 100 day moving average.

Example 3 : 200 DMA Resistance

The image below shows the daily chart of Inox Leisure from July 2007 to November 2007 where you can see price is clearly facing resistance at its 200 day moving average.



2. Generate Trading Signals

A moving average can also be used to generate trading signals. Popular trading signal generation strategies based on moving averages include Golden Crossover and Death Crossover.

Golden Crossover –

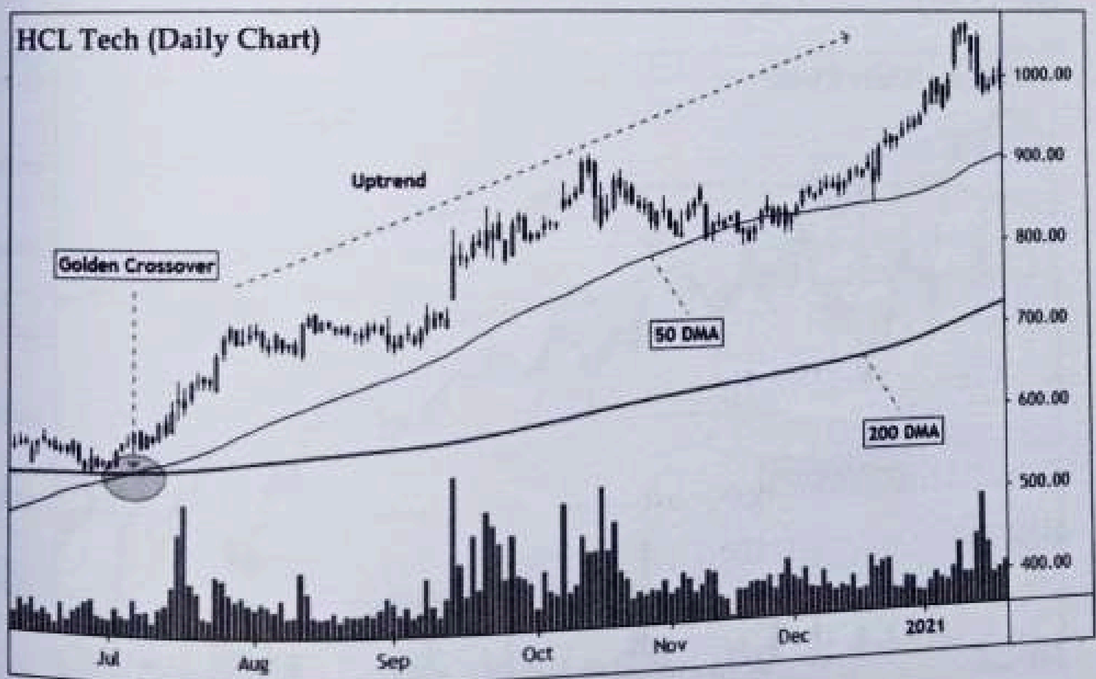
It is a bullish crossover strategy that makes use of two moving averages and generates a signal for taking long position. It signals for a major upside rally.

Golden crossover appears on the chart when a short term moving average rises above the long term moving average. This bullish crossover strategy works well when it is accompanied by a spurt in volume when the crossover happens.

It is the most widely used crossover strategy across the globe. The moving averages which are used in golden crossover are 50 and 200 day moving averages.

Example : Golden Crossover

The image below shows the daily chart of HCL Technology from June 2020 to January 2021, showing an example of golden crossover. After the golden crossover on 7th July 2020, you can see a clear uptrend emerged on the chart.



Death Crossover –

It is a bearish crossover strategy that makes use of two moving averages and generates a signal for taking short position. It signals for a major downside rally.

Death crossover appears on the chart when a short term moving average falls below the long term moving average. This bearish crossover strategy works well when it is accompanied by a spurt in volume when the crossover happens.

It is the most widely used crossover strategy across the globe. The moving averages which are used in death crossover are 50 and 200 day moving averages.

Example : Death Crossover

The image below shows the daily chart of Axis Bank from July 2015 to February 2016, showing a clear example of death crossover. After the death crossover on 14th September 2015, you can see a clear downtrend emerged on the chart.

3. Placement of Stop Loss or Trailing Stop Loss

Moving average can also be used as stop loss or trailing stop loss.

I have discussed about it ahead in chapters dedicated to stop loss and trailing stop loss respectively.

Important Note : Don't use moving averages in isolation. Always first look at the price action followed by volume analysis and then make use for moving average to get additional input or confirmation.

PRICE REJECTION AND PRICE ACCEPTANCE

Now that you have understood most of the basic concepts associated with Price Action Trading, let me come to an important concept associated with it that is about Price Rejection and Price Acceptance.

One of the most important questions in trading is, ***will the support or resistance level hold or fail?*** *The a*nswer to this question decides what type of trade you shall carry out (long or short) and ultimately to be successful in trading you need to get the correct answer to this question.

Many people don't realize that normally some important price action characteristics are observed at crucial support and resistance zones and if we are able to analyze price carefully at support or resistance then it is possible to tell in advance what is likely to happen around a support or resistance level. This is where the concept of Price Rejection and Price Acceptance comes into the picture.

Price rejection and price acceptance are the areas where there is no price equilibrium so it gives us an opportunity for taking breakout and pullback trade with a favorable risk to reward ratio.

Price Rejection –

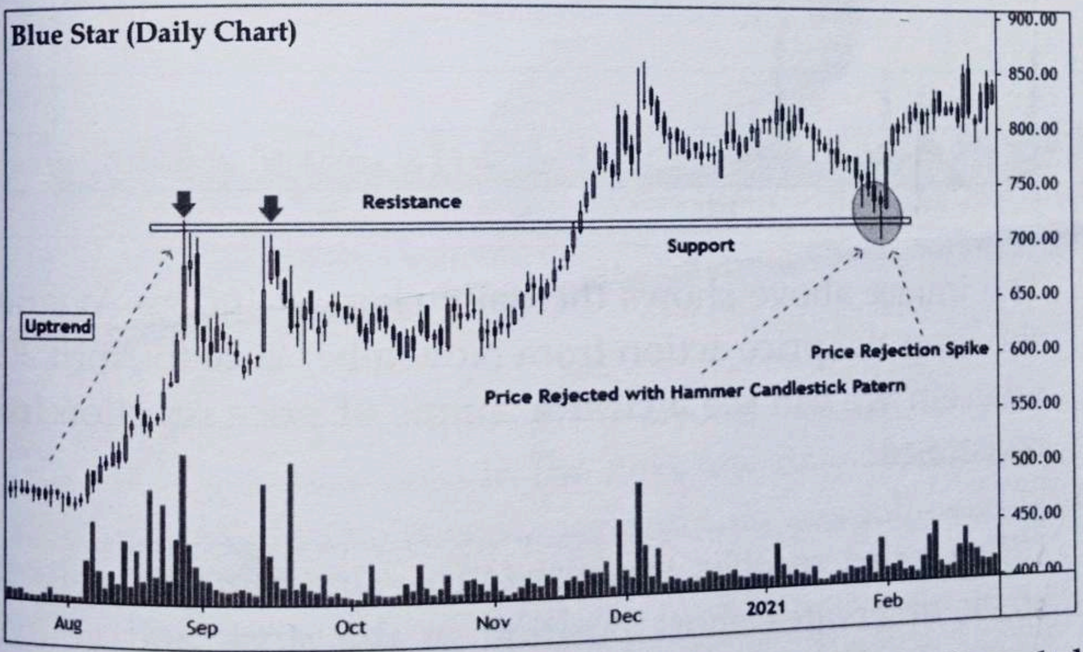
Price Rejection refers to the rejection of the break of a support or resistance level. It can be used for spotting reversal trading positions either at the resistance or at the support areas.

Price Acceptance -

Price Acceptance refers to the acceptance of the break of a support or resistance level. It can be used for spotting breakout trading positions either at the resistance or at the support areas.

I shall explain this concept and how to find whether the price will show clear rejection or acceptance with the help of a few examples.

Example : Price Rejection at Support

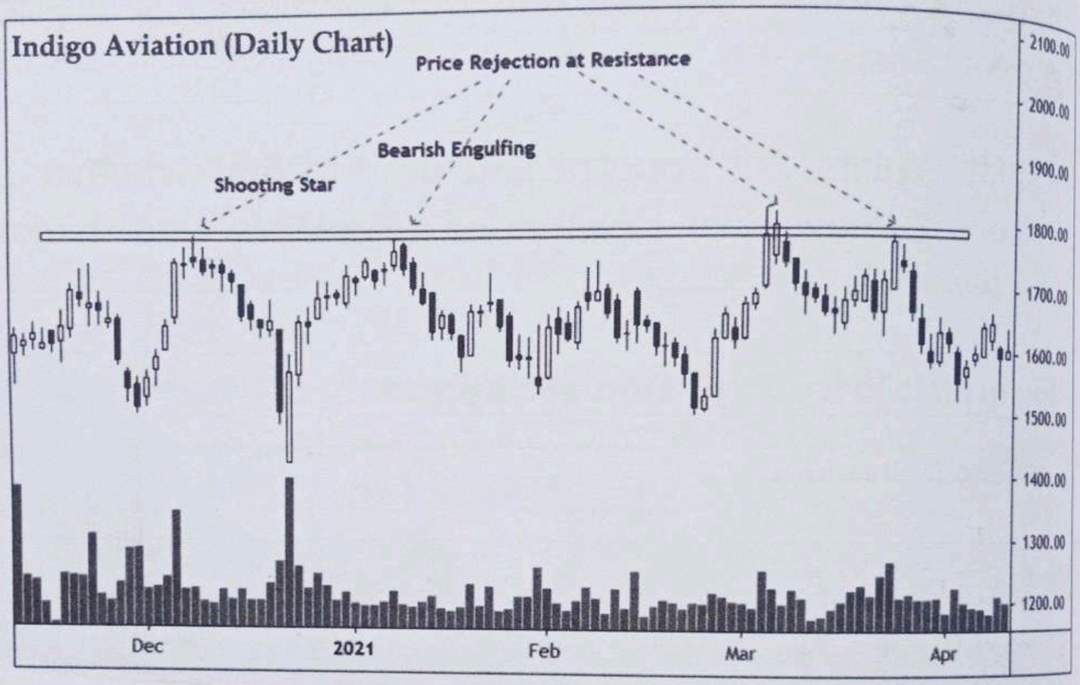


The image above shows the daily chart of Blue Star ltd showing the price action from August 2020 to March 2021 wherein we can see a clear example of price rejection from support.

When price reaches the support, smart buyers enter in and you can notice a hammer candlestick pattern which is a strong bullish reversal pattern. This gives an indication that price rejection will occur i.e., price won't break the support but will reverse from here.

Once the price rejection took place, traders could have entered a long position to profit from it.

Example : Price Rejection at Resistance



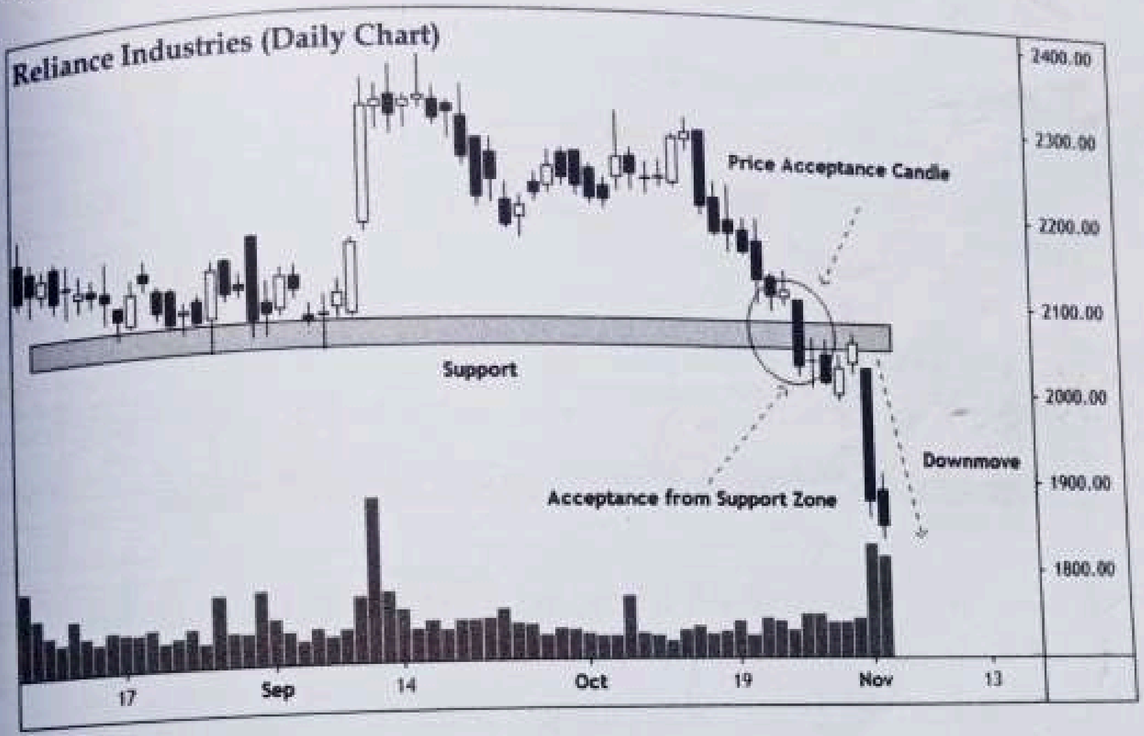
The image above shows the daily chart of Indigo Aviation, showing the price action from November 2020 to April 2021 wherein we can see a clear example of price rejection from resistance.

When price reaches the resistance, smart money sells the stock or creates short position in the stock and you can notice bearish reversal candlestick patterns like Shooting Star, Bearish Engulfing Pattern and Bearish Harami.

This gives an indication that price rejection will occur i.e., price won't break resistance but will reverse from here.

Once the price rejection takes place at the resistance area, the price reversed and gave a sharp down move. Traders could have entered short positions to profit from it.

Example : Price Acceptance at Support

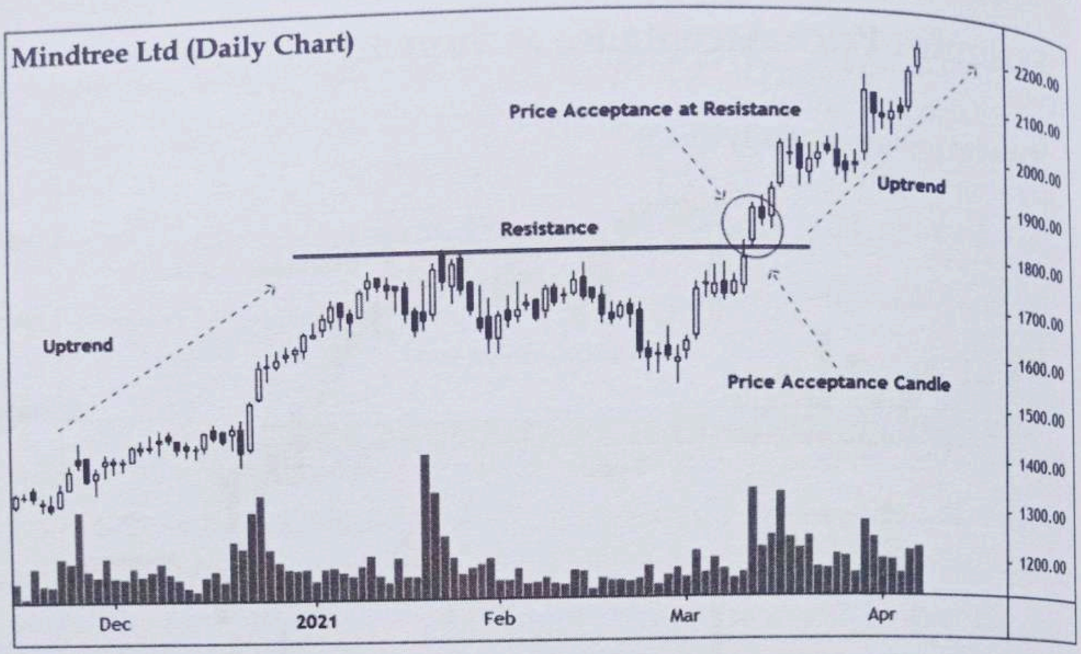


The image above shows the daily chart of Reliance Industries, showing the price action from August 2020 to November 2020 wherein we can see a clear example of price acceptance at support.

Support was broken through a strong bearish candle. A small pullback was seen in the next few days which failed. This confirmed price acceptance and this was followed by a sharp down move. Traders who would have entered a short trade on price acceptance would have benefited.

Example : Price Acceptance at Resistance

The image on the next page, shows the daily chart of Mindtree Ltd, showing the price action from December 2020 to April 2021 wherein we can see a clear example of price acceptance at resistance.



Resistance was broken through a strong bullish candle. This was followed by strong buying in the next few days and this confirmed price acceptance and this was followed by a sharp up move. Traders who would have entered a long trade on price acceptance would have benefited from the continuing uptrend.

Bottom Line –

When you observe strong bullish candle like ***Bullish Marubozu*** or bullish reversal candlestick patterns like ***Hammer, Inverted Hammer, Bullish Engulfing, Bullish Harami, Morning Star, etc*** near support zone then there is higher probability of Price Rejection at Support. Otherwise there is higher probability of Price Acceptance at Support.

When you observe strong bearish candle like ***Bearish Marubozu*** or bearish reversal candlestick patterns like ***Hanging Man, Shooting Star, Bearish Engulfing, Bearish Harami, Evening Star, etc*** near resistance zone then there is higher probability of Price Rejection at Resistance. Otherwise there is higher probability of Price Acceptance at Resistance.

RISK MANAGEMENT

Mark Douglas, in his book 'The Disciplined Trader', says successful trading is 80% money management and 20% strategy. This is where ***Risk Management*** comes into the picture.

Risk Management is one of the most important part of trading for becoming a successful trader which is unfortunately ignored by most of the traders.

Believe it or not, I have seen many traders and investors who do not give much importance to risk management aspect while trading or investing and hence end up losing big money.

Before I proceed further, I would like to mention a famous quote of a famous Hedge Fund Manager Larry Hite,

"I have two basic rules about winning in trading as well as in life:

1. If you don't bet, you can't win.
2. If you lose all your chips, you can't bet."

Another important point which one should always remember is, the bigger your loss, the more difficult it gets to recover it in the future.

This can be understood by looking at the table shown on the next page.

% Loss	% Gain Required in Future for Break Even
10	11
20	25
30	43
40	67
50	100
60	150
70	233
80	400
90	900

To recover from a loss of 10% you need to make a gain of approx 11 % in the future. But at the same time, to recover from a loss of 50% you need to make a gain of 100% in the future. Hence it is very important to manage risk at all times while trading.

Risk Management :

Risk management helps cutting down losses and also helps to protect a trader's account from losing all of its money. After all, a trader who has generated substantial profits can lose all of it in just one or two bad trades without a proper risk management strategy.

Although risk management is a key aspect to long term success in trading, it is still the most underrated aspect of trading, for many people.

So, it is my humble request, never underestimate the importance of risk management aspect in your trading journey.

Risk Management Strategies :

Risk management rules and strategies are not tough to understand, even a beginner can easily understand them. The only problem being, it is difficult for people to implement them while trading because human emotions of *ego, greed* and *fear* are involved in it.

A beginner would require a lot of practice to get into a habit of following these risk management strategies in each and every trade.

Risk Management Strategies –

- Following the Trend
- Plan the Trade
- Trade with appropriate Risk : Reward Ratio
- Control Emotions
- Position Sizing
- Applying Strict Stop Loss
- Booking Profits

Following the Trend –

One of the basic, simplest and most important ways of managing risk is trading in the direction of the trend.

When you trade with the ongoing trend, your chances of being wrong are very less and this automatically reduces your risk of losing.

If a security or an index is in a clear uptrend then try to take long positions like buying at support and selling at resistance.

Similarly, if a security or an index is in a clear downtrend then try to take short positions i.e., selling at resistance and buying back at support.

Never ever try to take contrarian trades i.e., never trade against the trend.

Always remember this age old saying related to trading,
"Trend is Your Friend."

Plan the Trade -

There is an age old saying in business, ***"If you fail to plan, you plan to fail."*** The same thing applies to trading.

Successful traders are highly disciplined and always trade according to their trading plan.

Having a plan is essential for achieving trading success. It mainly revolves around when to enter, how long to hold and when to exit any trade. In the absense of a trading plan, a person ends up making random trades and does not stick to a particular entry or exit strategy and eventually ends up losing money.

This is where the habit of maintaining a trading journal comes handy. I shall discuss this in detail ahead in the book.

Trade with appropriate Risk-Reward Ratio -

Another important risk management method involves trading based on a pre-defined risk-reward ratio.

The risk-reward ratio helps investors manage their risk of losing money on trades.

The risk-reward ratio compares the potential profit of a trade to its potential loss. It is calculated by dividing the difference between the entry point of a trade and the stop loss order (risk) by the difference between the profit target and the entry point (reward).

A risk-reward ratio of 1:2 means that if you are putting a stop loss of let's say 10 rupees than your expected profi from that trade should be 20 rupees.

Ideally, to enjoy consistent profits in trading, one shoul have a risk-reward ratio of 1:2 or more.

There is no thumb rule regarding the ideal risk-rewar ratio. It purely depends on a persons risk taking ability an trading style. Some trial-and-error is required to determin which ratio suits you the best, but in any case it should b more than 1:2.

Before entering any trade, a trader should calculate th possible risk-reward ratio for that trade and if that ris reward ratio is below the trader's acceptable risk-rewar ratio then such trades should be strictly avoided.

Control Emotions –

Fear and greed are often identified as the main drivers financial markets. At the same time, they play an importa role in the psychology of trading.

Fear is often observed when a trader is reluctant to enter a trade or closes a winning trade prematurely. ***Greed*** on other hand manifests when a trader aims to make quick money adding more capital to winning trades or over-leveraging and taking risk beyond his capacity to handle.

Even if you have a proper plan and trading system but if you are not following it honestly because of fear and greed due to market moves then you will never be able to make money consistently.

Hence, in case of trading, in order to be successful in long run, you need to take control of your emotions and make sure fear and greed do not influence your trading decisions.

I would suggest beginners to read Trading Psychology related books to learn about this vast subject of controlling human emotions while trading.

Position Sizing –

Position sizing is an important way of managing risk while trading. As the name itself indicates, it is a way of deciding the size of the position which a trader takes while trading. In other words, it refers to the amount of money a trader puts into a particular trade.

A traders risk taking ability and his trading capital or portfolio should be taken into consideration while deciding the size of trading position.

I have explained this concept with the help of a few practical examples ahead in the book as it is one of the most important aspect for trading.

Applying Strict Stop Loss –

One of the easiest and most effective ways of risk management is using a strict stop loss.

The idea behind the use of stop loss is to close your losing position if the market goes against you, before you lose too much money and wipe out a substantial portion of your trading capital.

Booking Profits –

Taking profits from your positions regularly is also very important while trading in securities. Before entering any trading position you should have a clear plan about when to exit your position or when to book profit.

Although it is often said that to be successful in trading, one should learn to limit the losses and let the profits run. But at the same time, as a trader one should always remember that real profit is what you book, everything else is just profit on paper, not in reality and it can vanish anytime and under extreme events, it can change into loss as well.

Professional traders normally use the concept of trailing stop loss to book profits. I have explained this in detail ahead in the book.

POSITION SIZING

Position sizing is an important way of managing risk while trading. In fact, risk management starts with position sizing, before you initiate your trade.

As the name itself indicates, it is a way of deciding the size of the position which a trader takes while trading. In other words, it refers to the amount of money a trader puts into a particular trade.

A traders risk taking ability and his trading capital or portfolio should be taken into consideration while deciding the size of trading position.

Professional traders use the concept of position sizing to decide what quantity of security they should buy or sell. This helps them in minimizing the risk and maximizing the returns.

If your position size is too big or too small, you may end up taking a lot of risk or end up not taking enough risk for you to earn enough profit from a trade.

Calculation of Position Size -

Before understanding how to calculate ideal position size, let us first try to understand two important aspects involved in its calculation –

1. Account Risk
2. Trade Risk

Account Risk refers to a set percentage of trading capital or a certain specific sum as a limit for the risk you are willing to take per trade.

So, for example if your trading capital is of Rs. 1,00,000 and you have set a percentage risk limit at 1% then you are willing to take risk upto Rs. 1000 per trade.

Generally, a trader should not risk more than 2% to 5% of his trading capital for any trade. Not only that, the account risk limit should be kept unchanged for all the trades.

Trade Risk refers to the difference between the trade entry point and the point where you place your stop loss order.

The stop loss is defined based on certain criteria which I have explained in the next chapter.

So, for example, if you bought shares of a company at Rs. 100 with a stop loss placed at Rs. 90 then your trade risk in this case is Rs. 10 per share.

Now once you know how far the stop loss is from your entry point (in rupee terms), then you can calculate your ideal position size for that trade.

Ideal Position Size = Account Risk / Trade Risk

Example :

Consider a trader having a trading capital of Rs. 5,00,000 wishing to go long on shares of ABC Company at Rs. 80 with a stop loss of Rs. 76 for a price target of Rs. 90.

Now the ideal trading size for the trader can be calculated as follows –

Assuming 2% risk limit set by the trader for all trades, the account risk in this case will be 2% of 5,00,000 = Rs. 10,000

Trade Risk = Entry – Stop Loss = 80 – 76 = **4 Rs.**

Now ideal Position Size = 10,000 / 4 = **2500 Shares.**

Let us assume ABC Company trades in derivatives with trading lot of 500 shares.

Now, in this case, the person can either trade 2500 shares in cash market or trade 5 lots (2500/500) in derivatives.

Following such an approach, you will get an ideal position size, no matter what the market conditions are, what the trade setup is, or what strategy you are using.

Always remember, a big trading position always causes anxiety.

Famous American trader and author Jack Schwager quotes,

"The larger the position, the greater the danger that trading decisions will be driven by fear rather than judgment and experience."

So one should always trade within your financial and emotional capacity. This is where position sizing plays an important role.

INITIAL STOP LOSS

A stop loss order is a tool used by traders and investors to limit losses and reduce risk exposure. Putting a stop loss order means limiting the losses on a trade, if the trade goes against you.

A **sell stop loss order** is a type of stop loss order that protects long positions; it is set below the current market price and is triggered if the price falls to that level.

A **buy stop loss order** is a type of stop loss order that protects short positions; it is set above the current market price and is triggered if the price rises to that level.

Nobody wants to lose their hard earned money when they are trading in securities and hence it is important to place a stop loss in the trading system as soon as you execute any trade.

To emphasize the importance of stop loss, I am presenting below two important quotes –

"Be it short term traders or long term investments, always set and stick to "stop loss". Once the stop loss gets triggered, just book the minimal loss and exit. Never be too hopeful and hold on to the losing position."

~ Anonymous

"It's not whether you're right or wrong, but how much money you make when you're right and how much you lose when you're wrong."

~ George Soros

Stop loss order helps to prevent large and uncontrollable losses, especially when the market or the security in which you are trading becomes volatile.

I have seen many people who say that we place the stop loss in our mind and when the trade goes against us then we will simply book the loss. However, I would like to suggest everyone that never place a stop loss in your mind instead place it on the system.

If you are not using stop loss or just placing the stop loss in your mind, then it is only a matter of time when a large losing position will get out of your control and wipe out not only most of your trading profits but also wipe out your initial trading capital.

I have also seen people selling out their houses and other assets by losing all the money while trading and this happens only because of not having a proper stop loss strategy to limit the losses.

So, always place a stop loss in your trading system as soon as you execute a trade!

One key advantage of using a stop loss order is that, you don't need to monitor your trading position continuously.

Many people, especially beginners find it hard to decide where to put the stop loss and hence in this chapter I shall explain some common ways of calculating stop loss.

There are several stop loss strategies available but in the end, everything depends on the traders risk taking capacity and the maximum amount he can afford to lose per trade.

Setting a stop loss too far from the entry level might result in big losses and setting a stop loss very close to the entry level might result in stop loss getting hit very soon which will lead you to get out from the trade quickly.

Therefore, it is very important to set the stop loss at an appropriate price and get out from the trade if the trade goes against you.

To succeed in trading, every trader must establish a trading plan and stop loss is an important part of any trading plan.

A trading plan helps you to know where to book the profit and where to book the loss if the trade doesn't pan out according to your plan.

It is a common fact that around 95%of people lose money in trading and this is mainly because they don't have a proper trading plan before entering a trade and don't know when to exit.

Ahead I have explained some popular stop loss strategies. Always remember, there is no right or wrong strategy. The stop loss strategy that you select should be purely based on your trading style, risk taking capacity and the maximum amount you are willing to lose per trade.

What works for you and what does not work, can only be known by trying each of the stop loss strategies for a certain time.

Never think that what works for others will work for you.

Types of Stop Loss Strategies :

1. Percentage based Stop Loss
2. Moving Average based Stop Loss
3. Support / Resistance based Stop Loss
4. Pattern based Stop Loss

Percentage based Stop Loss –

In this method, stop loss is calculated as certain 'X' percentage points below (for long positions) or above (for short positions) the entry price of your trade, depending on the amount of money you can afford to lose per trade. I shall explain this with the help of a few examples.

Imagine you bought shares of a particular company at Rs. 100 per share (long position) and you can afford to loose 5% of your trading capital in this trade. Then, in this case, you will place a stop loss order in the system at Rs. 95 which means if the price falls to Rs. 95 your position will be squared off, resulting in a loss of Rs. 5 per share. (5% of Rs. 100).

Now consider you sold a futures contract of a particular company at Rs. 500 per share (short position) and you can afford to lose 5% of your trading capital in this trade. Then, in this case, you place a stop loss order in the system at Rs. 525 which means if the price rises to Rs. 525 your position will be squared off, resulting in a loss of Rs. 25 per share. (5% of Rs. 500)

This is the simplest strategy of applying a stop loss. But this is not a scientific method and hence suited only for newcomers.

Moving Average based Stop Loss –

In this method, stop loss is placed below a particular moving average which is below the trade entry price (for long position) or above a particular moving average which is above the trade entry price (for short positions).

Now selection of the moving average period depends on your trading i.e., whether you have taken an intraday, swing, positional or short term trade. The well-known moving averages are 10, 20, 50, 200 day moving averages and these can be deployed on the chart and used for setting up a well predefined stop loss.

I shall explain this with the help of a few examples.

Imagine you bought shares of a particular company at Rs. 100 per share (long position) for short term swing trading whose 50 day moving average is at Rs. 96. Then in this case, you place a stop loss order in the system slightly below Rs. 96.

Now consider you took a short position for intraday trading selling shares of a particular company at Rs. 200 whose 20 day moving average is at Rs. 205. Then, in this case, you place a stop loss order in the system slightly above Rs. 205.

Support / Resistance based Stop Loss –

Experienced traders often use this method for placement of stop loss and this is more accurate and reliable method.

In this method, stop loss is placed below support level in case of long position and above resistance level in case of short position.

This is a bit difficult method as compared to previously mentioned methods as in this case you have to study the chart and identify crucial support and resistance levels.

Details about how to plot support and resistance levels on a chart have been explained earlier.

I shall explain this with the help of a few examples.

Imagine you bought shares of a particular company at Rs. 50 per share (long position) for short term whose chart shows an immediate support at Rs. 45 then in this case you place a stop loss order in the system slightly below Rs. 45.

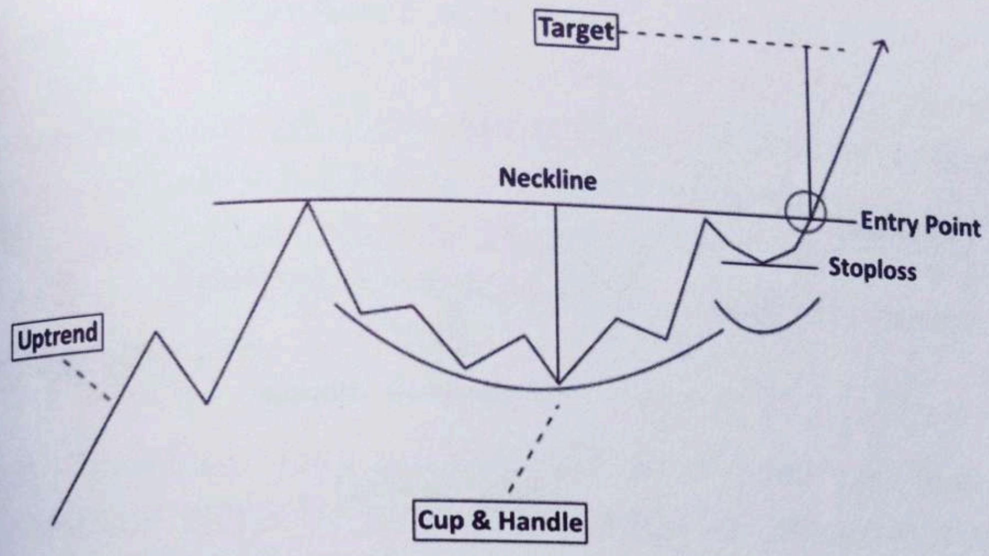
Now consider you sold a futures contract of a particular company at Rs. 250 per share (short position) whose chart is showing a strong resistance at Rs. 260 then in this case you place a stop loss order in the system slightly above Rs. 260.

Pattern based Stop Loss –

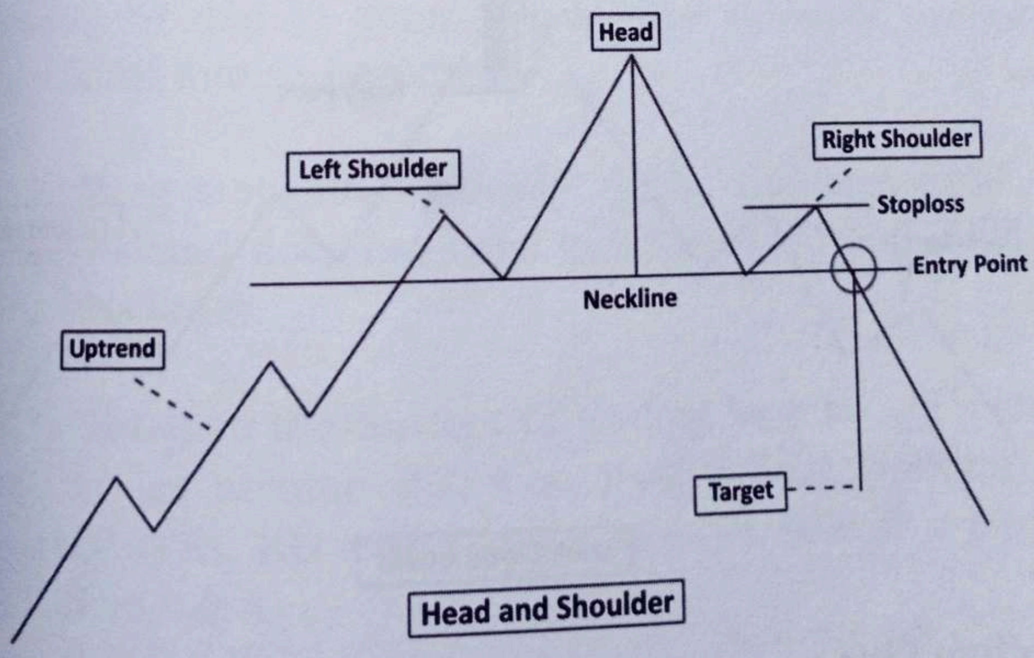
This is a commonly used strategy for placement of stop loss and used by traders who trade securities on the basis of trading signals obtained from various chart patterns or candlestick patterns.

In case of this strategy, stop loss placed entirely depends on the chart pattern or candlestick pattern based on which trading was carried out.

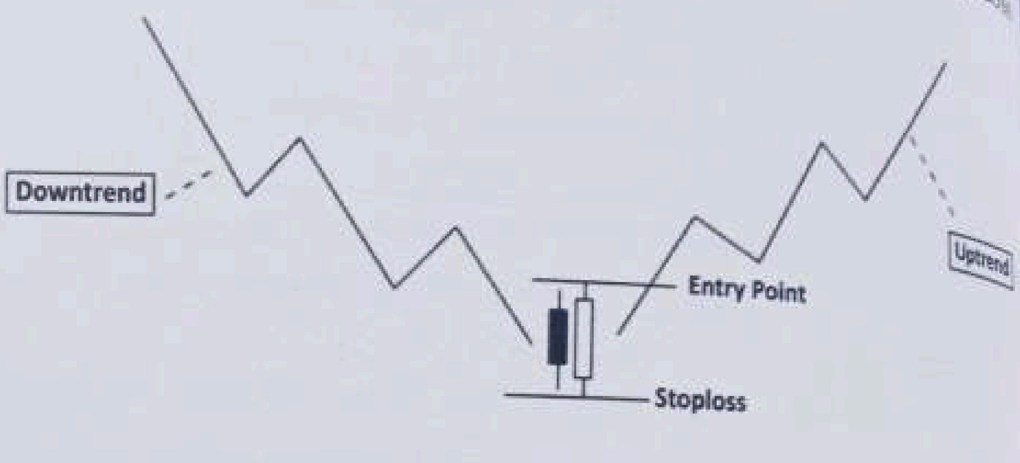
For example, if you spot a cup and handle chart pattern in a stock and take a long position based on that, then you will place your stop loss just below recent swing low of handle of chart pattern as shown in the figure on the next page.



Simiarly, if you spot a head and shoulder pattern in a stock and take a short position based on that, then you will place your stop loss just above the edge of the right shoulder as shown in the figure below.

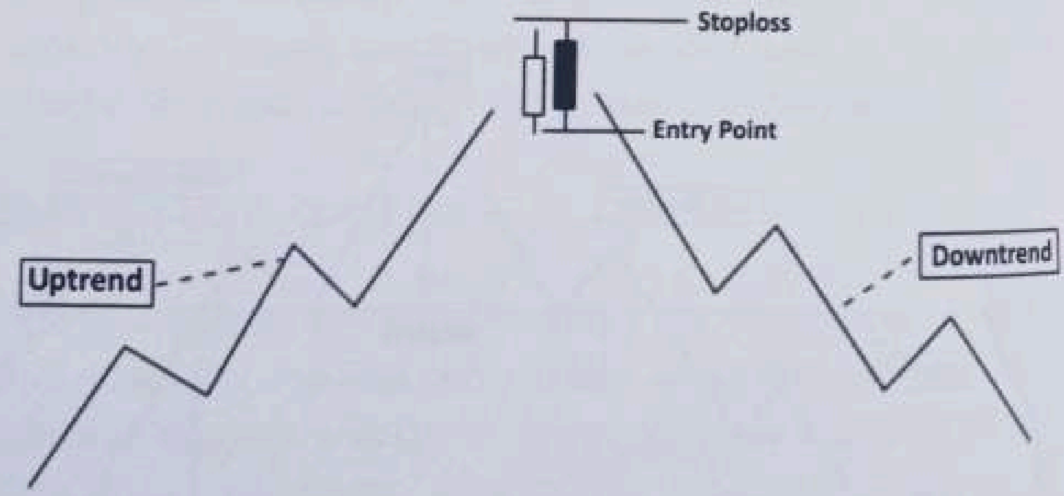


If you spot a candlestick pattern such as the bullish engulfing pattern in a stock and take a long position based on that, then you will place your stop loss just below the low of bullish engulfing candlestick pattern as shown in the figure below.



Bullish Engulfing

Similarly, if you spot a dark cloud cover candlestick pattern in a stock and take a short positon based on that, then you will place your stop loss just above the high of dark cloud cover candlestick pattern as shown in the figure below.



Dark Cloud Cover

Bottom Line :

Never trade any security without setting up a stop loss method because if you don't place a stop loss in the system then one day your entire capital might get wiped out if the trade goes against your view.

TRAILING STOP LOSS

In case of trading or investing, to make money it is often advised to cut your losses and let your profits run. At the same time, it is also advised to never let a profit turn into a loss. This can only be achieved by using the concept of trailing stop loss.

A trailing stop loss is designed to reduce the loss and protect the gains by enabling a trade to remain open and continue to profit as long as the price is moving in your favor.

As mentioned above, the trailing stop loss serves two purposes. Firstly, it acts as a protection against loss of capital. Secondly, it also acts as a cushion to protect your profits so that at some point your notional profits are translated into real profits.

A trailing stop automatically tracks the security's price direction and does not have to be manually reset like the stop loss order.

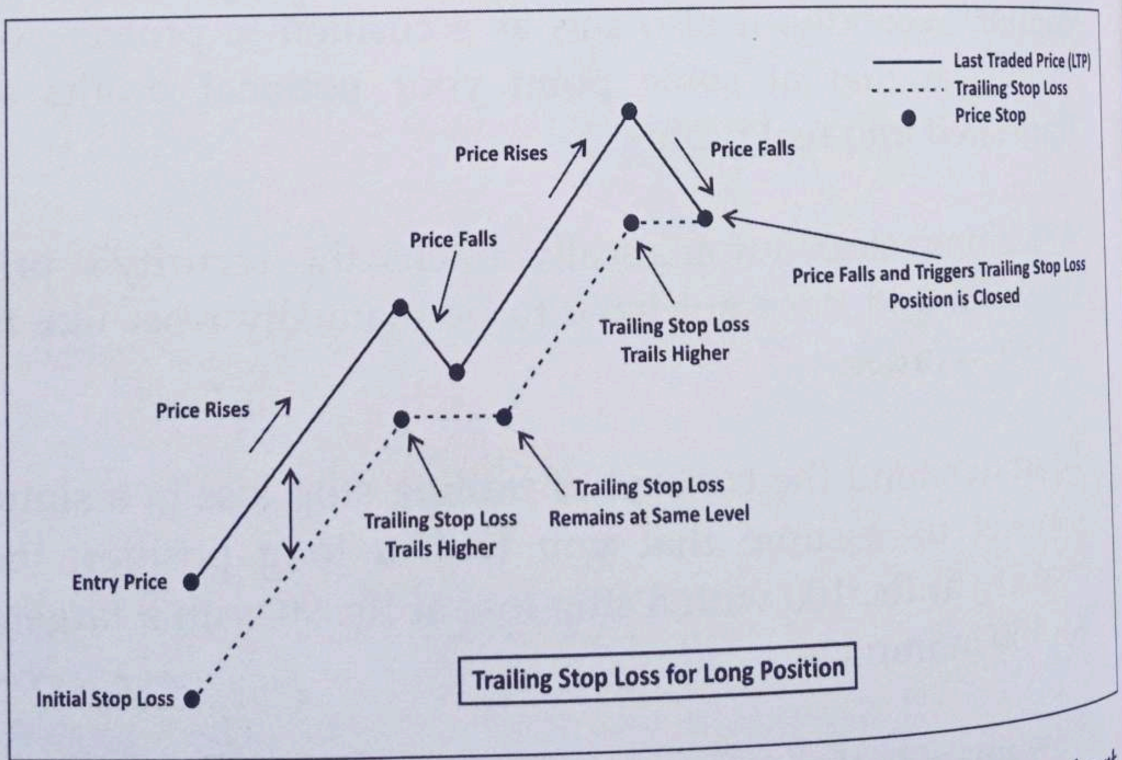
To understand the concept of trailing stop loss in a simple way let us assume that you took a long position in a security at Rs. 100 with a stop loss at Rs. 90 with a target of Rs. 130 in mind.

Now imagine the position starts playing out in your favour and the price of the security rises to say Rs. 110. Now you can trail your stop loss from Rs. 90 to Rs. 100.

Assume that the price rises further to Rs. 130. In this case you further trail your stop loss and now take it to Rs. 120 from Rs. 100. Although you had set a target of Rs. 130, you actually don't book profit at that level, you keep trailing higher. Let us assume that the price reaches Rs. 150. Now your trailing stop loss will automatically be set at Rs. 140. This way you keep on trailing your stop loss and exit the position only when your trailing stop loss gets hit.

In general, in case of a long position, a trailing stop loss is placed below the current market price of a security and it trails upward as the price moves higher.

The same thing has been explained below with help of a pictorial representation.

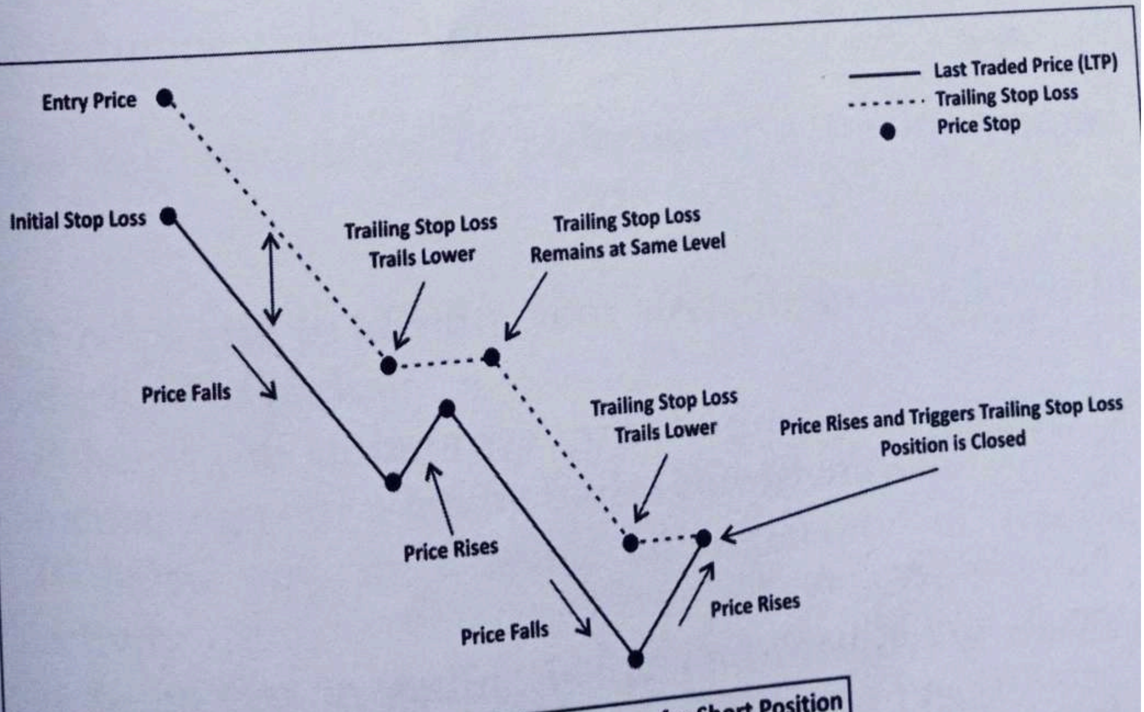


Now let us consider another example, this time of a short position. Let us assume that you took a short position in a security at Rs. 500 with a stop loss at Rs. 520 with a target of Rs. 425 in mind.

Now imagine the position starts playing out in your favour and the price of the security falls to say Rs. 480. Now you can trail your stop loss from Rs. 520 to Rs. 500. Assume that the price falls further to Rs. 450. In this case you further trail your stop loss and now take it to Rs. 470 from Rs. 500. Although you had set a target of Rs. 425, you actually don't book profit at that level, you keep trailing lower. Let us assume that the price reaches Rs. 380. Now your trailing stop loss will automatically be set at Rs. 400. This way you keep on trailing your stop loss in the direction of price movement and exit the position only when your trailing stop loss gets hit.

In general, in case of a short position, a trailing stop loss is placed above the current market price of a security and it trails downward as the price moves lower.

The same thing has been explained below with help of a pictorial representation.



Trailing Stop Loss for Short Position

Theoretically, trailing stop loss can be placed using several strategies just like you place the initial stop loss order in the system. However in reality to place a trailing stop loss in the trading system of your broker which can trail automatically, normally you have only two options - trail by percentage or trail by absolute value.

TRADING JOURNAL

A trading journal is the most effective tool for trading performance management. It helps traders to become consistent and profitable.

A trading journal is just like your "Dairy" wherein you record all your trading activity. By maintaining a detailed journal, it becomes easier for traders to analyze their trade results and identify reasons why certain trades worked well, while others didn't and resulted in a loss.

You may include data like traded security, entry level, stop loss and target, position size, risk-reward ratio, whether or not you were successful, market conditions and even notes on your emotions.

A trading journal can help you spot your trading mistakes so that they can be avoided in the future and also help you in fine-tuning your trading strategy.

Some key advantages of maintaining a trading journal include –

1. It helps you to identity your strength and weakness in the field of trading.
2. It helps you to improve your trading performance by increasing your winning trades consistently.
3. It helps you in keeping accountability of trading activity.
4. It helps you in getting better and identifying trading strategies that work for you.
5. It helps you in avoiding repetitive mistakes.

Main Elements of a Trading Journal :

Some of the main elements which one should record in a trading journal are highlighted below. It is not necessary that you may include all of these elements.

You can customize your trading journal to fit your trading style.

- **Date and Time –** Each journal entry should include the date and time when the trade was initiated.

- **Traded Instrument –** In this field you can include the financial instrument which you traded i.e., name of the stock or currency or commodity, index, derivative contract, etc.

- **Direction of Trade –** In this field you mention the direction of the trade, i.e., you went long or short.

- **Price Points –** Here price point refers to three separate fields – Entry Price, Stop Loss and Exit Price.

- **Position Size –** In this field you enter the position size of your trade.

- **Risk:Reward Ratio –** In this field you enter the risk-reward ratio of the trade. If you are using an excel spreadsheet for your trading journal then this field can be calculated automatically after you enter price point fields. This field will help you later to analyze whether you take too much risk on your losing trades or took too less risk in your profit making trades.

- **Result of Trade –** In this field you enter the amount of profit or loss you made in the trade.

- **Chart –** Some professional traders who use excel or other such electronic means to maintain a trading journal also add a price chart for each of their trades in their trading journal which helps them in analyzing their trades while reviewing their trading journal later on.

- **Additional Notes –** You can also record additional information in your trading journal to suit your needs like - why you took a particular trade, market condition, any external news which affected your trade, etc.

Making a Trading Journal –

Making a trading journal is easy. There are two ways of doing it – manually writing all your trading activity related information in a physical diary or maintaining the data in an electronic form in an excel spreadsheet.

The image below shows a sample excel based trading journal spreadsheet.

	B	C	D	E	F	G	H	I	J	K
1	Traded	Direction	Price Points			Position	Risk:Reward	Result	Chart	Additional Notes
2	Instrument	of Trade	Entry	SL	Target	Size	Ratio			
3										
4										
5										

It does not matter whether you maintain an excel based trading journal or a handwritten one. The only thing that matters is to record each and every trade you carry out in that journal and that too every day. If you fail to record all your trades accurately in the trading journal then it would become hard to judge your trading performance.

Many times, people get into the habit of making a trading journal only to stop the process after few days. If you are a beginner, then at first, maintaining a trading journal might seem tedious and time-consuming. But believe me, recording your trades teaches consistency and discipline, both of which pay off in the long run.

Always remember that just maintaining a trading journal is not enough, you should always keep reviewing it to monitor your trading activity to learn about your mistakes so that you can avoid them in the future.

CASE STUDIES

Below I have presented 49 case studies to practically explain what all I have so far explained in the book theoretically. I have used examples of stocks, indices, commodities, cryptocurrencies, bullion, etc

In most of the examples, I have used the concept of trailing stop loss and started trailing the stop loss as soon as the trade is entered. As I believe that beginners should first aim at protecting their capital and take less risk while in the learning phase and at the same time learn to be able to book maximum amount of paper profits.

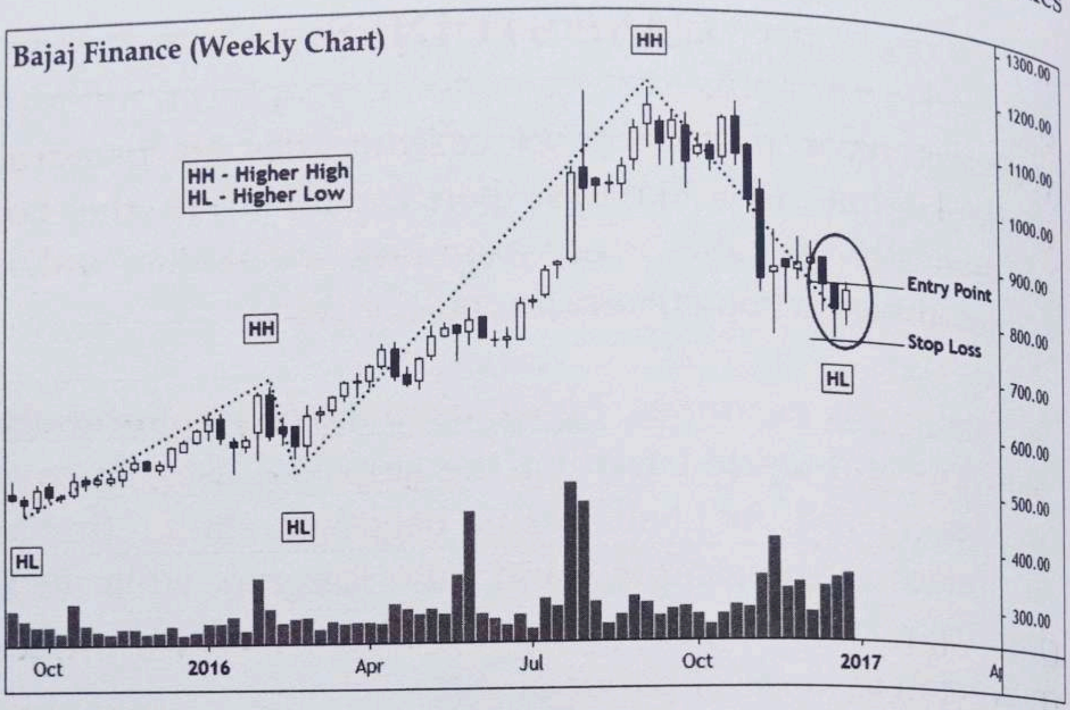
With time, as a trader gains more experience, he can switch to other methods of applying trailing stop loss like using moving average, using a trailing stop loss on a closing basis, using support and resistance for stop loss, using wider stop loss for volatile stocks, etc.

Through these case studies, I have tried to present different viewpoints and scenarios which a trader can face during realtime trading.

Case Study 1 : Trading in Up Trending Market (HH&HL Structure)

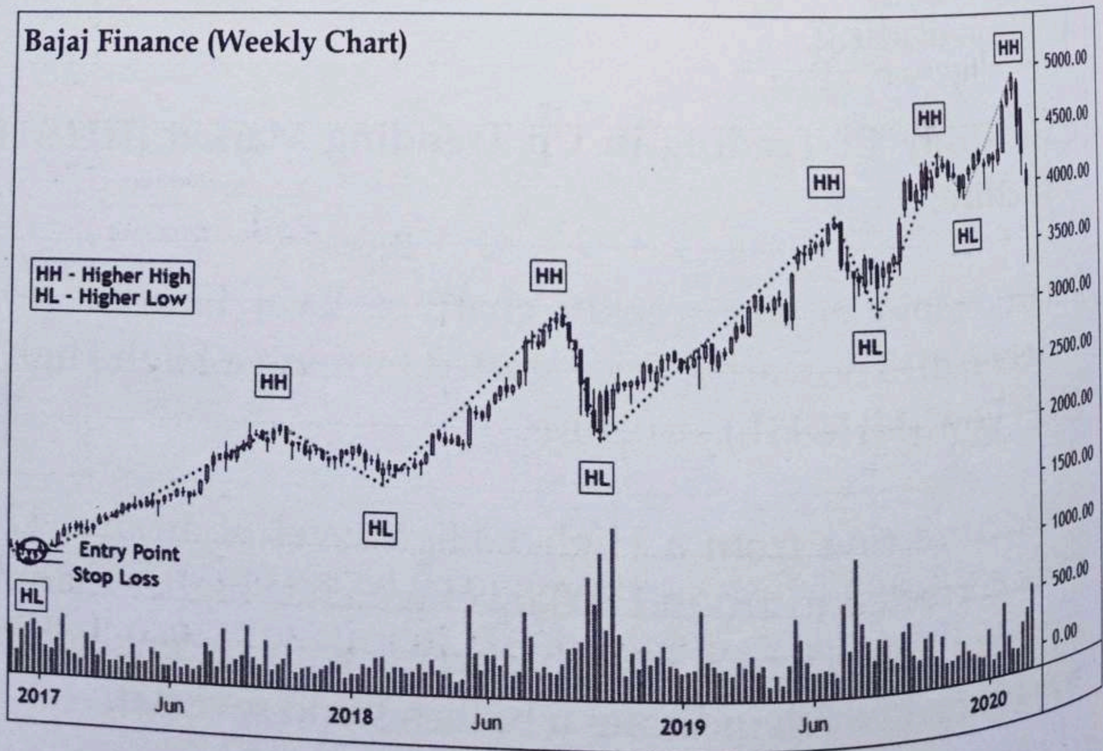
Chart below is the weekly chart of Bajaj Finance from October 2015 onwards. Price started forming a High High & High Low (HH&HL) structure.

After correcting from a Higher High level of around 1200 stock corrected to around 800 level which is higher than the previous low. Here a bullish harami with decent volume was formed which indicates a bullish trend reversal.



A long position is taken above 847 (high of the second candle) placing the stop loss below 755 (low of the second candle) with an initial target above the previous higher high of 1200.

After initiating a long position, the stock started marching upward and gave a decent up move. This can be seen in the chart below.

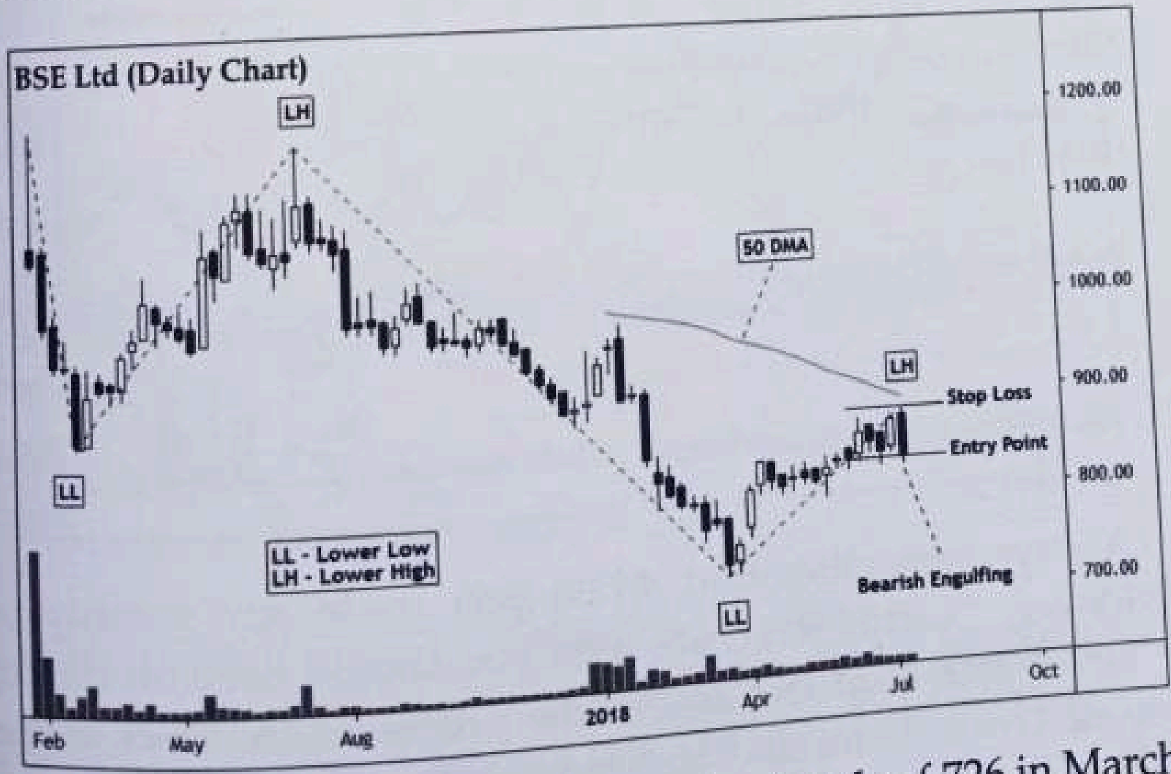


Always remember that when you buy any security on basis of HH&HL structure then you should keep on trailing up your stop loss and in the process if the stock makes a new Higher High and Higher Low then you can shift your stop loss to the previous swing low which is marked as HL (higher low).

Unless your immediate swing low gets broken you should not sell the stock and keep rolling up the stop loss and lock the upside profit.

Case Study 2 : Trading in Down Trending Market (LL&LH Structure)

Chart below is the daily chart of BSE Ltd from the time it listed on 3rd February 2017 onwards. Price started forming a Lower Low & Lower High (LL&LH) structure.

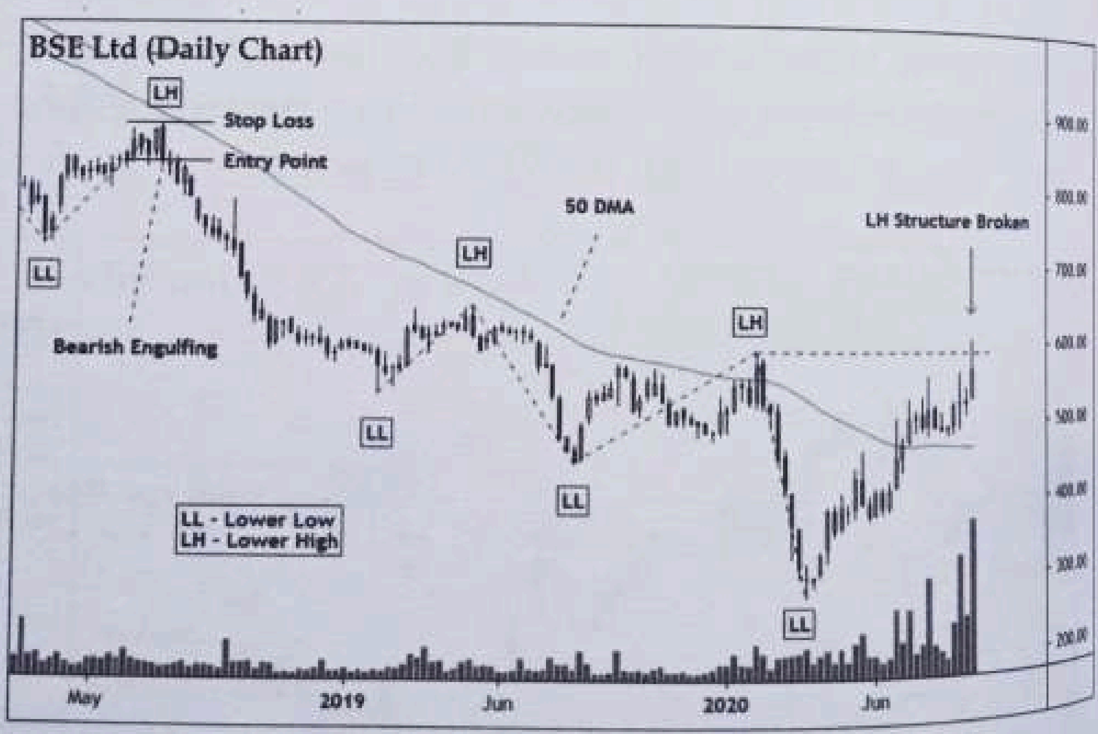


After listing at 1200 stock corrected to levels of 726 in March 2018 and then bounced back to 881 in July 2018 forming the LL&LH.

Here a bearish engulfing pattern was formed which indicated towards a bearish trend reversal. Price was also below the 50 DMA which gave an additional bearish confirmation.

A short position is taken below 826.70 (low of bearish engulfing pattern) placing the stop loss above 881 (high of bearish engulfing pattern) with an initial target below the previous lower low of 726.

After initiating a short position, the stock started marching down as expected giving a decent down move. This can be seen in the chart below.

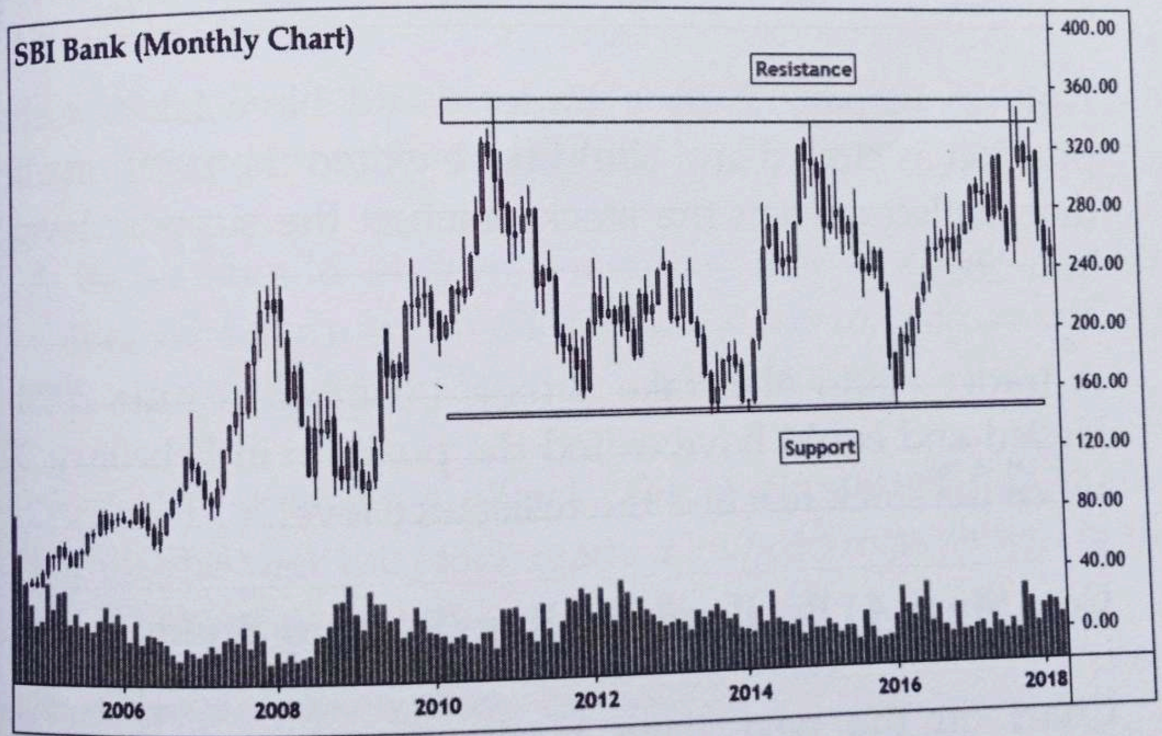


Always remember that when you trade any security on basis of LL&LH structure then you should keep on trailing down your stop loss and in the process if the stock makes new Lower Lows and Lower High then you can shift your stop loss to the previous swing high which is marked as LH (Low High).

Unless your immediate swing high gets broken you should not exit the short trade and keep rolling down the stop loss and lock the downside profit.

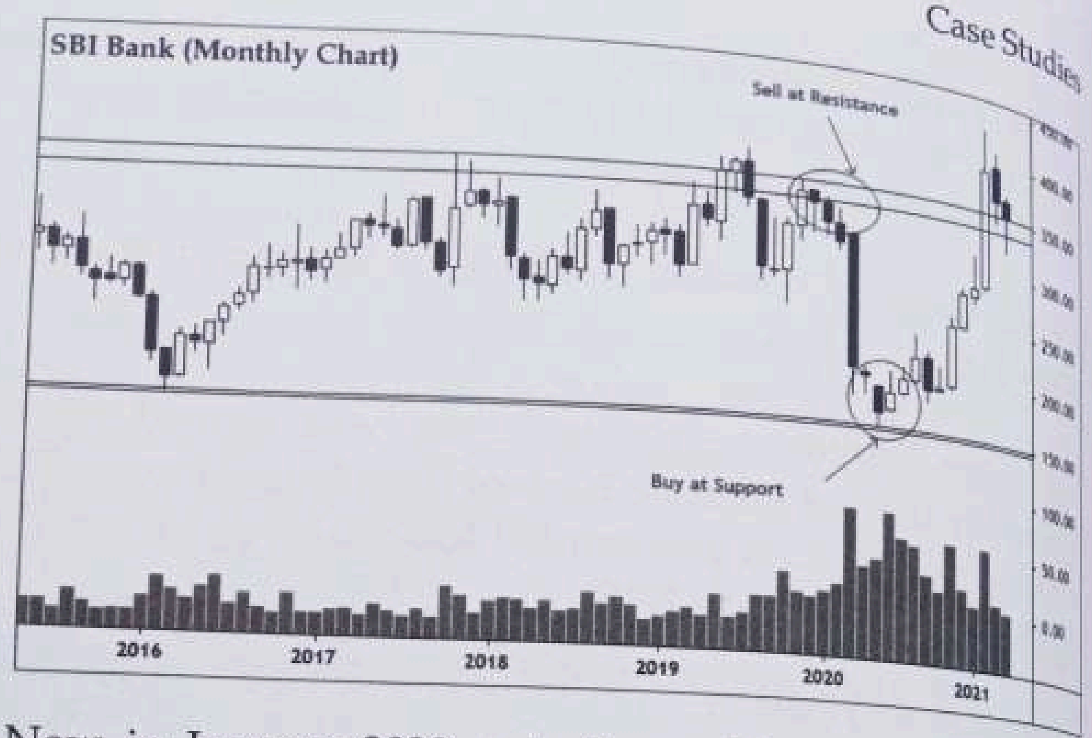
Case Study 3 : Swing Trading in Sideways Ranging Market

A range bound or sideways trend was formed on the monthly chart of the State Bank of India from January 2010. The stock was stuck between 150 and 350 levels for a period of 8 years from 2010 to 2018.



Here the level of 150 acted as a strong support and level of 350 acted as a strong resistance.

In such range bound market, whenever the stock comes near the support area one can take a long position and whenever the stock comes near the resistance area one can take a short position.



Now in January 2020, a trader could have taken a short position as circled and could have exited the position a few months later when the stock reached the support level in May 2020.

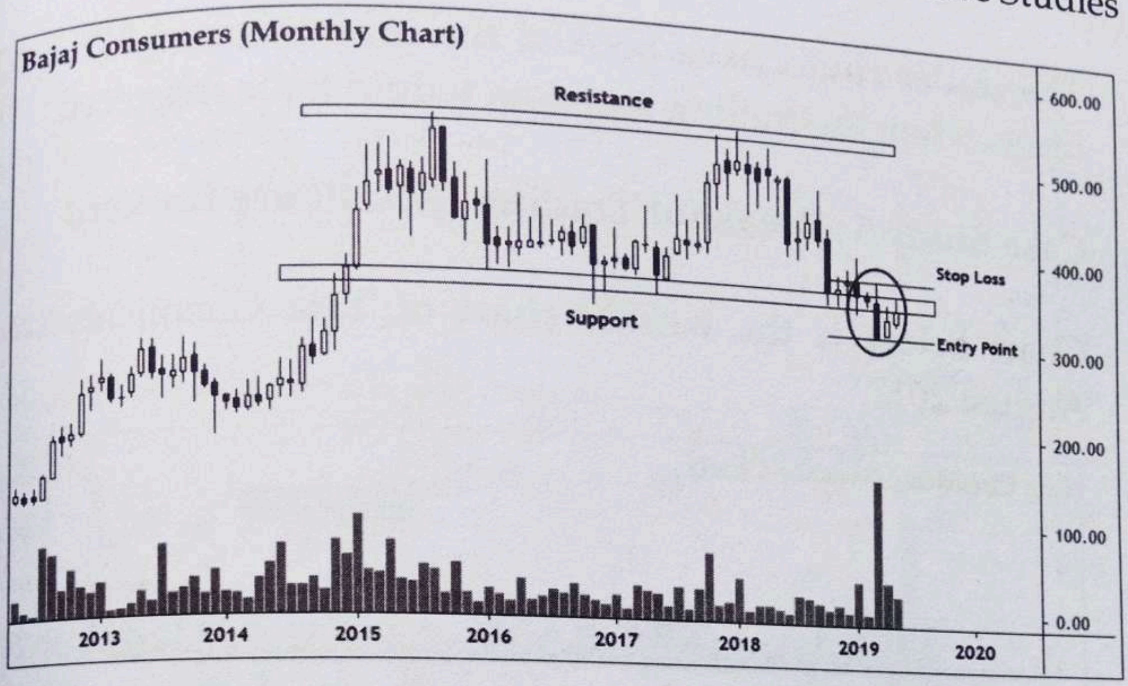
A trader could also take a long position in June 2020 as circled and could have exited the position in February 2021 when the stock reached the resistance level.

Case Study 4 : Breakout Trading (Support Broken)

Chart on the next page is the monthly chart of Bajaj Consumers from April 2012 onwards.

After making a top around 500 level in August 2015, the stock corrected and formed good support around 340 - 355 levels.

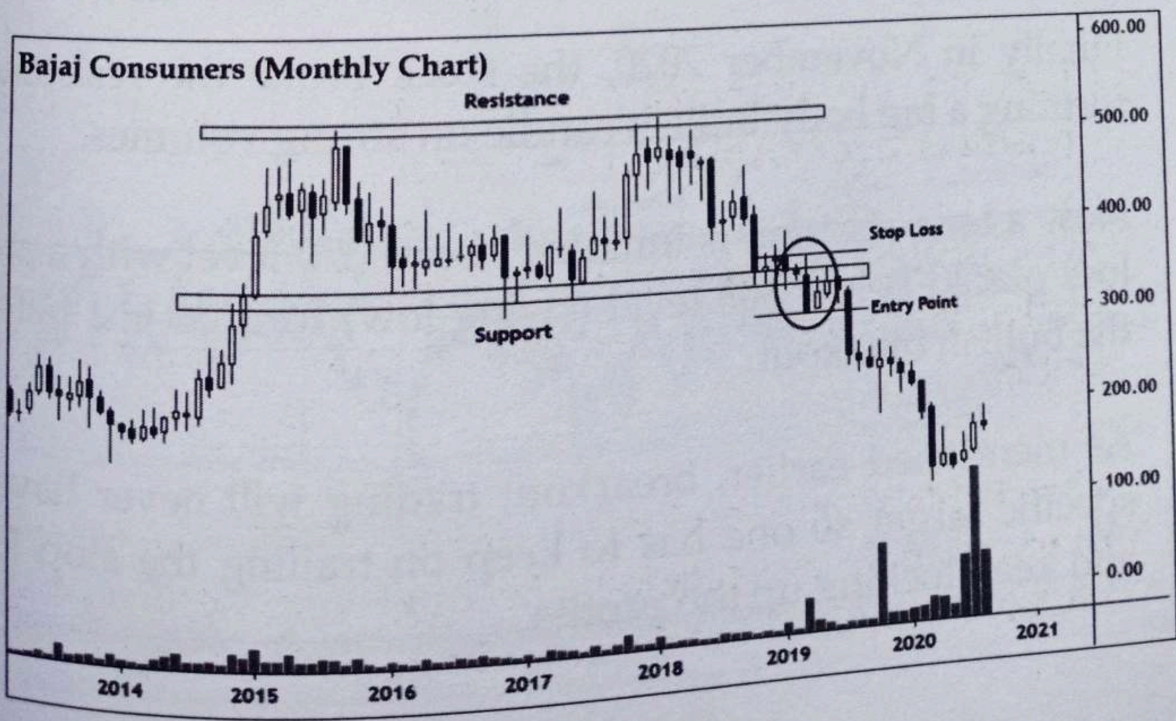
This support got broken in March 2019 when a strong bearish candle was formed with huge volume. This makes a perfect example of breakout trading.



Now a short position could be initiated below 309 (low of breakout candle) with a stop loss above 370 (swing high formed just before the breakout).

A trader should always remember that a breakout trade will never have a specific target so he has to keep on trailing his stop loss and keep locking up the profits.

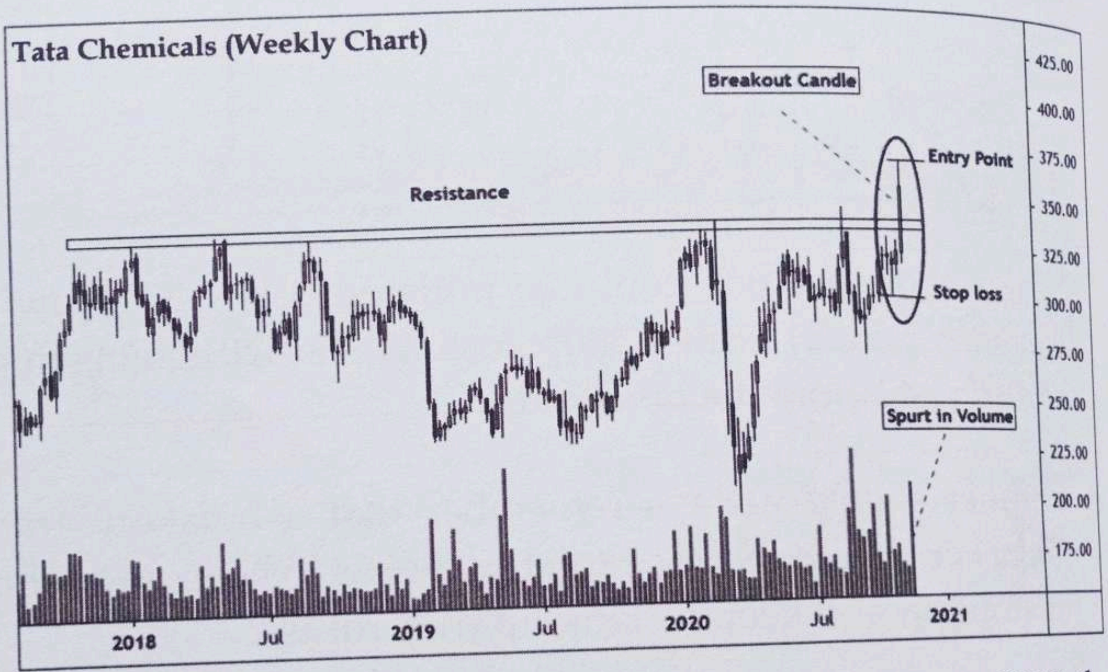
Now after a small pullback, the stock started falling and within one year the stock made a low of 116 as shown in the chart below.



The trader could have booked the profit around 125 - 135 levels when the trailing stop loss would have triggered.

Case Study 5 : Breakout Trading (Resistance Broken)

Chart below is the weekly chart of Tata Chemicals from August 2017.

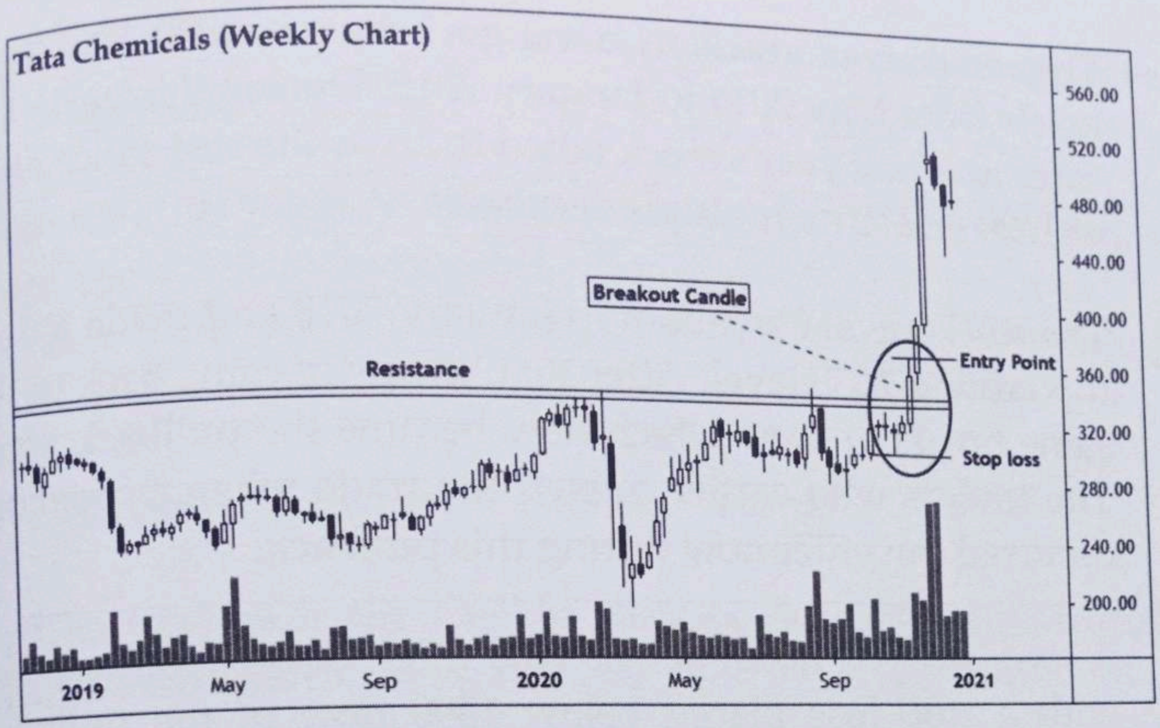


After making a top around 330 level in January 2018 the stock could not move higher. The stock faced this resistance multiple times between January 2018 and August 2020.

Finally in November 2020, the stock broke the resistance forming a big body bullish candle on strong volumes.

Now a long position is initiated above 370 level with a stop loss placed below 303 level (swing low) formed just before the bullish breakout.

As mentioned earlier, brearkout trading will never have a specific target so one has to keep on trailing the stop loss and keep locking up the profits.

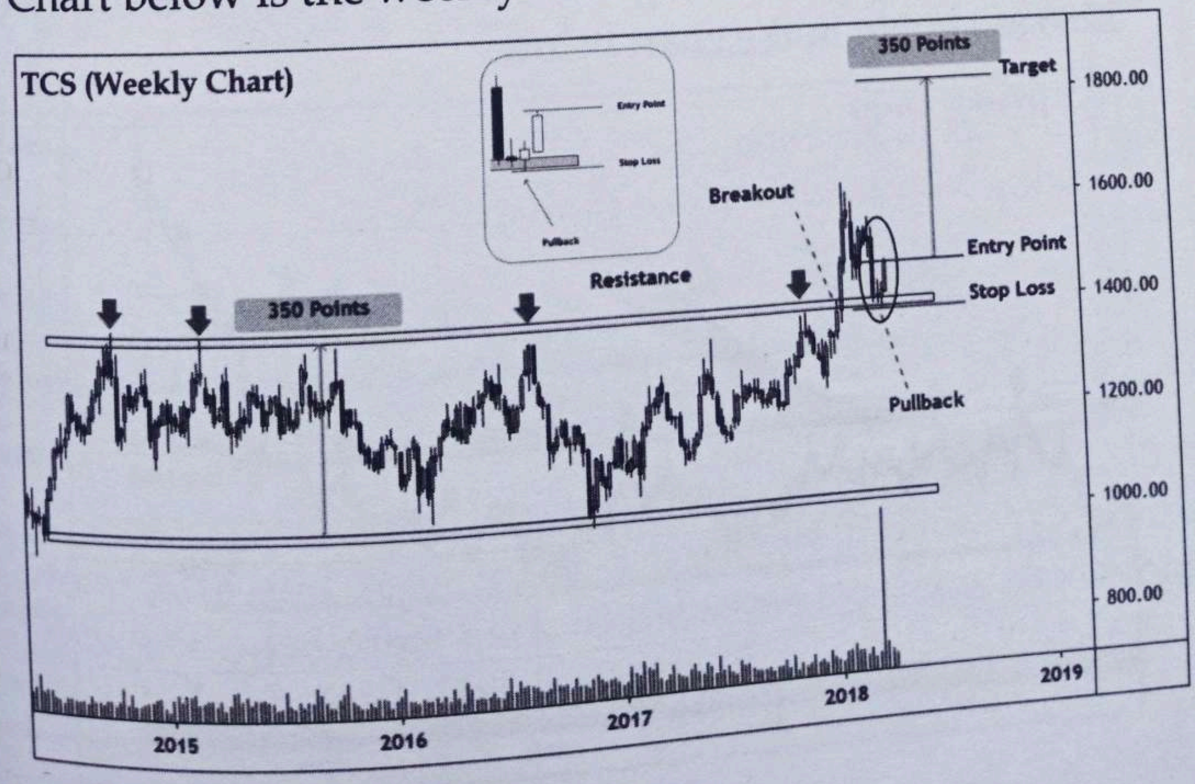


Now after the beakout, the stock moved from 370 to 520 in no time.

The trader could have booked the profit somewhere around 460 level when the trailing stop loss would have triggered.

Case Study 6: Bullish Pullback Trading

Chart below is the weekly chart of TCS from May 2014.



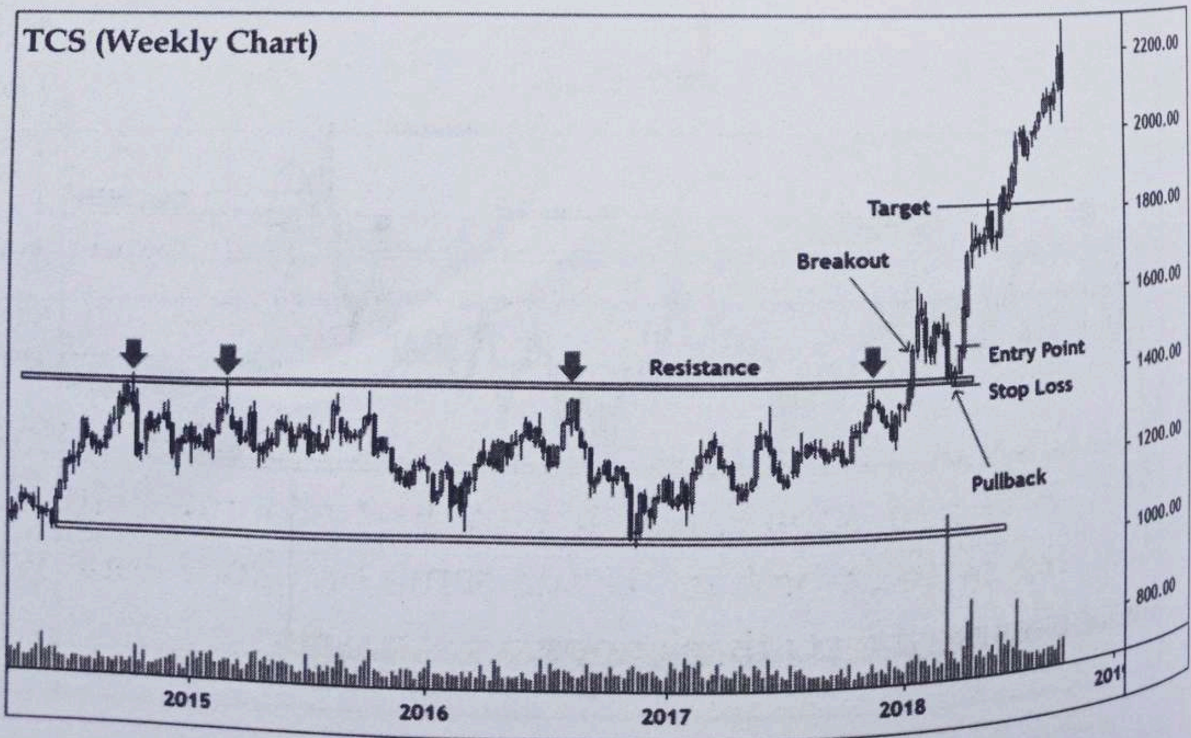
The stock was stuck in a range between 1000 and 1400 levels from May 2014 to January 2018. During this period of three and half year's stock failed to cross the resistance zone of 1390 – 1410 on multiple occasions.

The stock gave a breakout in January 2018 and made a new top around 1630 level. After that, the price came back to the same breakout zone which now became the pullback zone. The traders who earlier missed the trade when a breakout occurred can enter now during this pullback.

A long entry is taken above 1480 (high of breakout candle) with a stop loss placed below 1390 (low of the pullback area).

The target in the case of this trade is around 1830 i.e., 350 points (approx distance between support and resistance) above the entry point.

After a strong pullback forming a strong bullish candle, the price started moving up backed by increasing volume. The stock not only hit the target of 1830 but went all the way till 2200 as shown in the chart below.



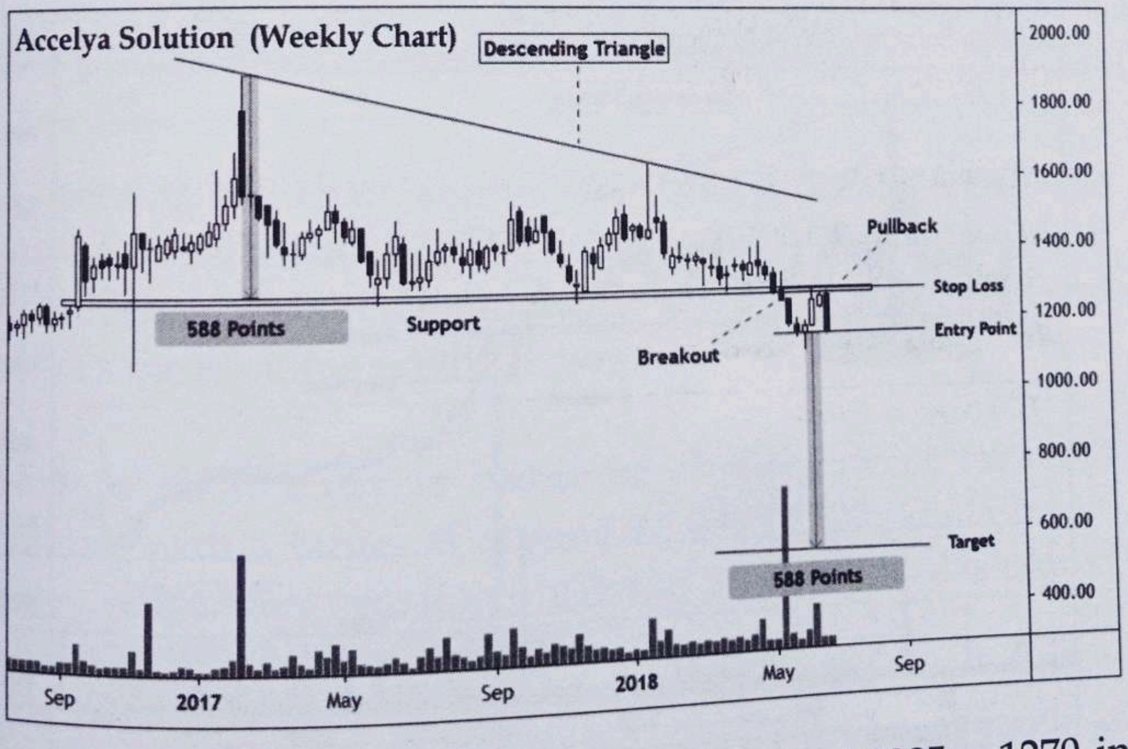
Traders who would have used trailing stop loss could have made an extra profit.

I would strongly recommend traders that if the price action of the stock is favourable, then do not book profit at the target zone, instead use a trailing stop loss and keep riding the profits.

Case Study 7: Bearish Pullback Trading

Chart below is the weekly chart of Accelya Solution from November 2015.

After making a top of 1890, the stock started correcting and formed a Descending Triangle pattern.



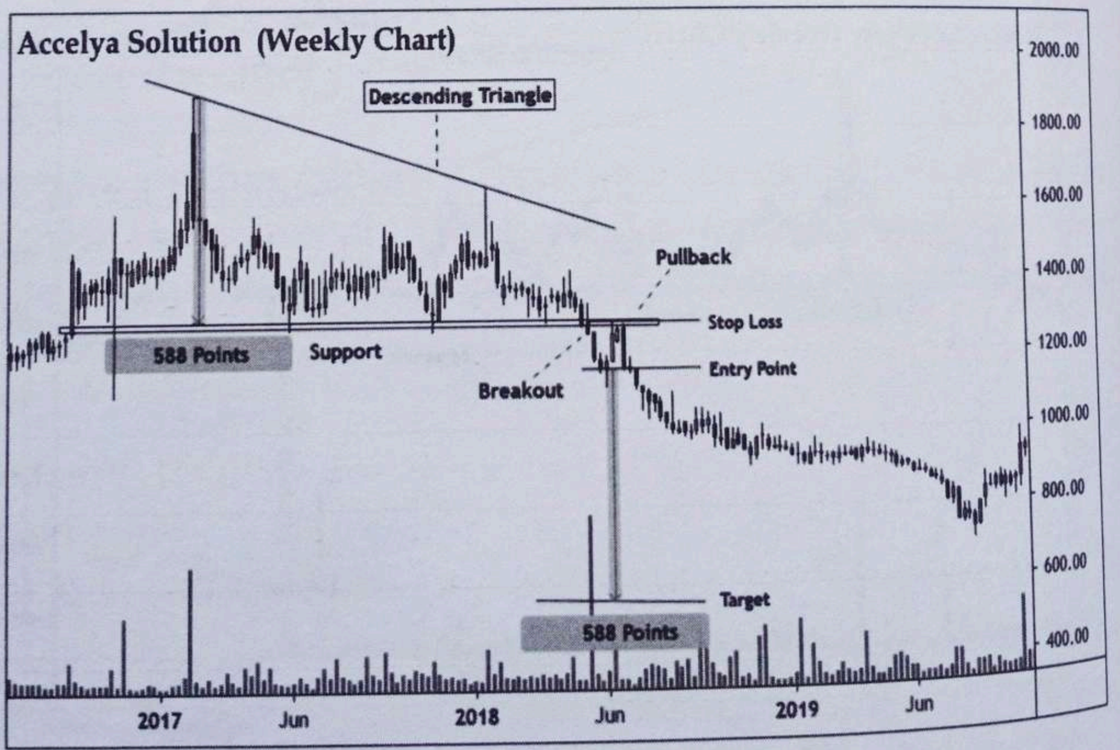
The stock broke the lower support zone of 1285 - 1270 in May 2018 and soon made a new low around 1110. After that, the price came back to the same breakout zone which now became the pullback zone.

The traders who earlier missed the trade when a breakout occurred can enter now during this pullback.

A short entry is taken below 1158 with a stop loss placed above 1285 (high of the pullback area).

The target in the case of this trade is around 570 i.e., 588 points (height of the descending triangle at its thickest point) below the entry point.

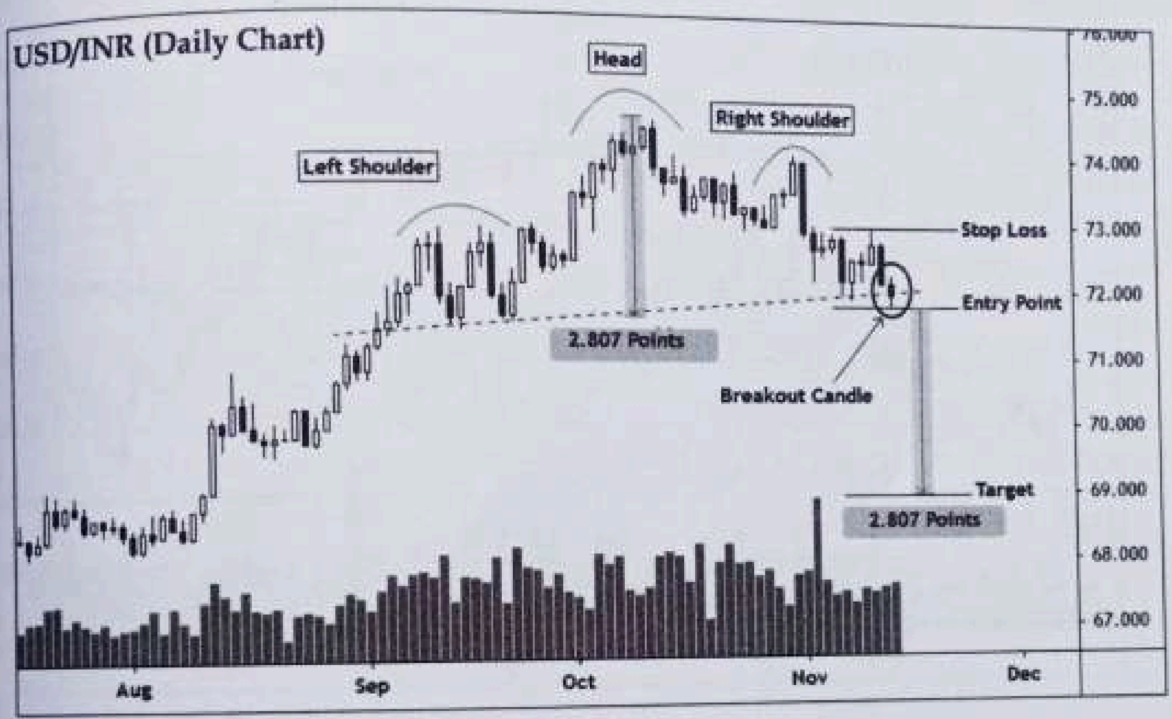
The stock started falling and hit a low of around 700. Although the target was not achieved but still people following trailing stop loss would have booked profits somewhere around 780 - 800 levels making a good enough profit.



This case study clearly signifies the importance of trailing stop loss.

Case Study 8 : Head & Shoulder Pattern

A Head and Shoulder Pattern was formed on the daily chart of USD/INR from July 2018 to November 2018 as shown in the chart below.

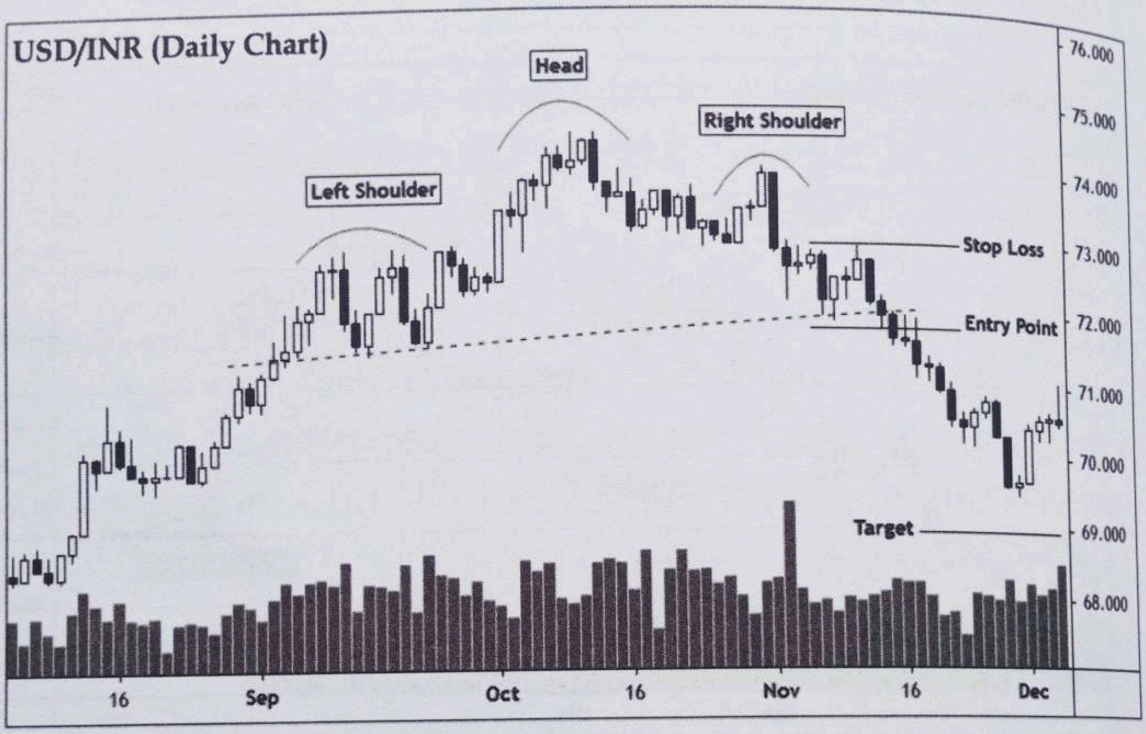


As seen in the chart above, after a long bullish trend, the price formed a left shoulder followed by a higher head and then formed a right shoulder. The price then falls again and breaks the neckline on the downside.

Now, a short entry is below at 71.768 (low of breakout candle) with a target of around 68.979 (2.807 points below entry point after neckline breakout) and stop loss is placed above 72.968 (high of right shoulder).

Now in the chart below you can see how the trend reversal took place after the breakout. The price of USD/INR currency pair fell from the level of 71.768 to hit a low of around 69.50 in 10 trading sessions.

Here the price reversed before hitting the target. After two consecutive long bearish candles, a doji was formed on 30th November 2018 which was a clear indication of reversal.



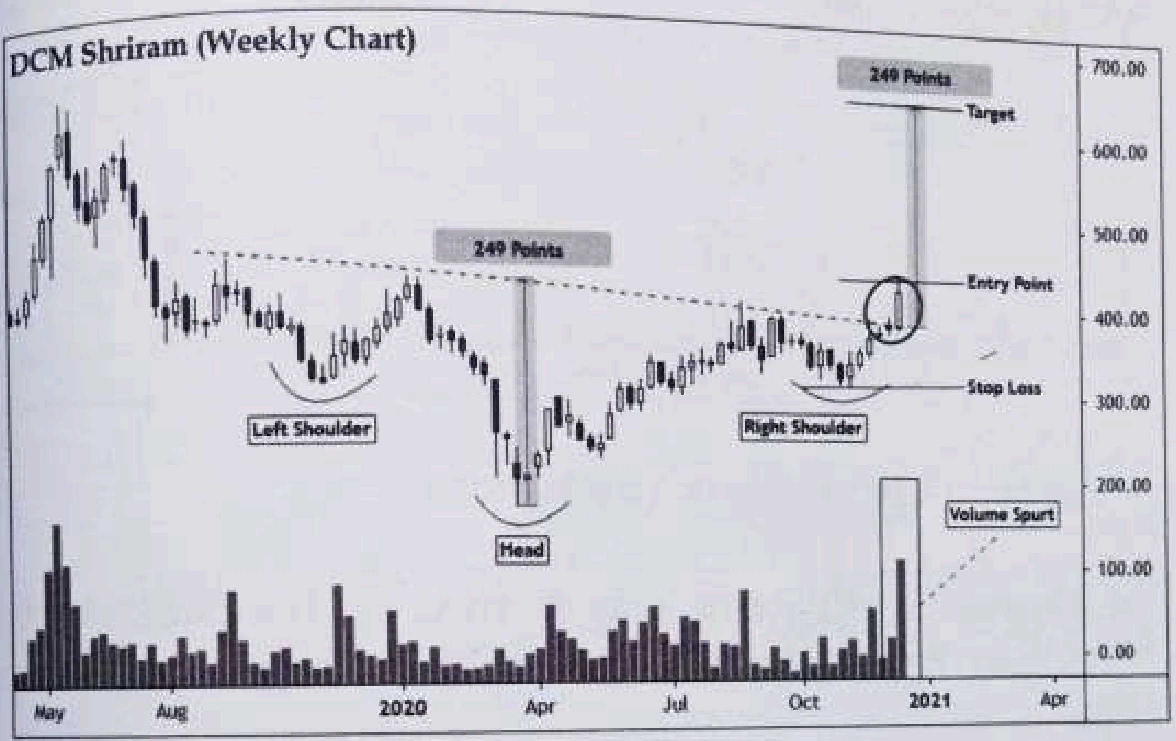
The next day price opened around the previous day's close and started rising closing near days high forming a strong bullish candle. Looking at price action it is advisable to book profits on such occasions before waiting for trailing stop loss to get triggered. Such exits looking at pure price action require a bit of experience which can be gained with constant practice.

Even if a person waited, the trailing stop loss would have hit two days later on 6th December 2018 around 70.660. In any scenario, a trader would have booked a profit of around 1.1 ~ 1.2 points.

This case study shows the importance of flexibility in case of trading.

Case Study 9 : Inverted Head & Shoulder Pattern

An Inverted Head and Shoulder Pattern was formed on the weekly chart of DCM Shriram from July 2019 to December 2020 as shown in the chart below.

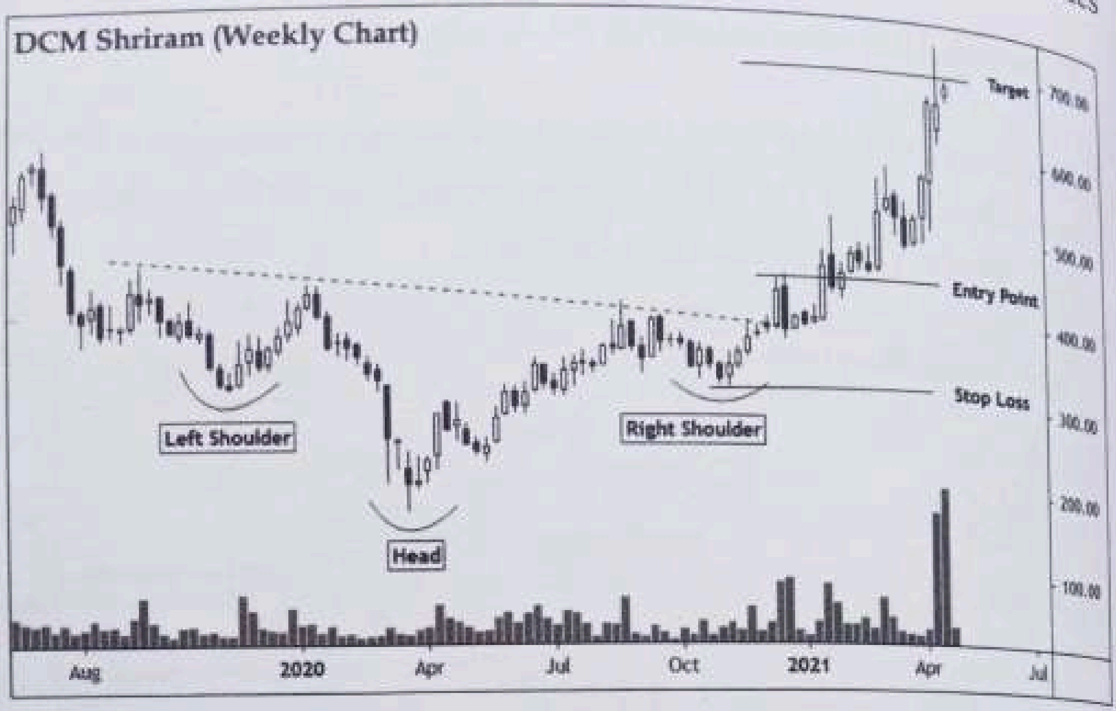


As seen in the chart above, after a long bearish trend, the price formed a left shoulder followed by a lower head and then formed a right shoulder.

The price then rises again and breaks the neckline on the upside with a strong bullish candle with huge volumes.

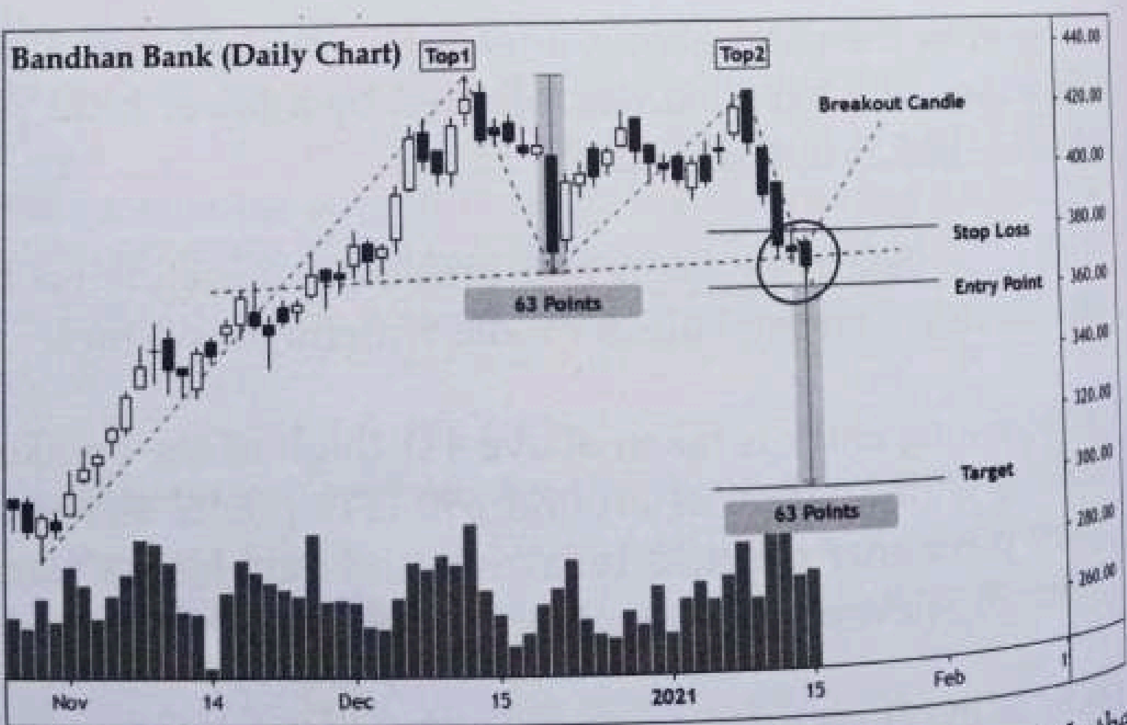
Now, a long entry is taken above 441 (high of the breakout candle) with a target of around 690 (249 points above the entry point after neckline breakout) and stop loss is placed below 315 (low of right shoulder).

Now in the chart below you can see how the trend reversal took place after the breakout. The stock rose from the level of 425 to 700+ achieving the target giving returns of over 60% in a period of 4 months.



Case Study 10 : Double Top Pattern

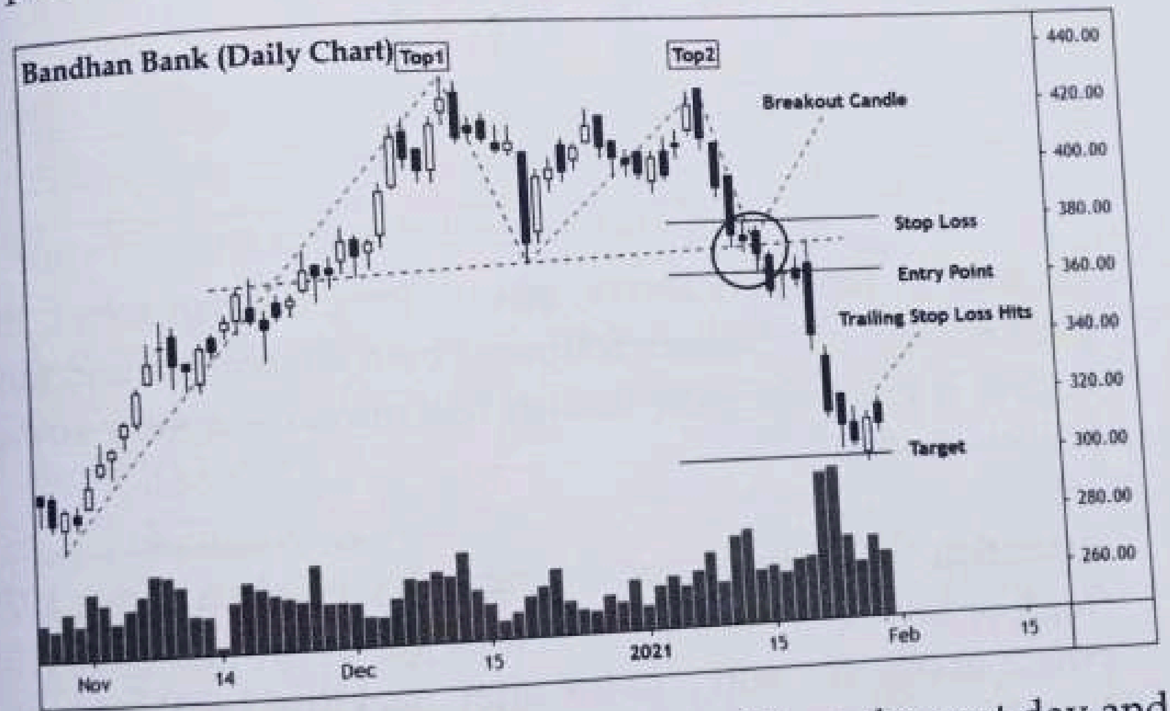
A Double Top Pattern was formed on the daily chart of Bandhan Bank from October 2020 as shown in the chart below.



As seen in the chart above, after a long bullish trend, the price formed a 1st top followed by a 2nd top and then it gave a breakout with a bearish candle.

After the breakout, a short entry is taken below 362 (low of breakout candle) with a target of around 299 (63 points below the entry point after neckline breakout) and stop loss is placed above 380 (high of the candle before breakout).

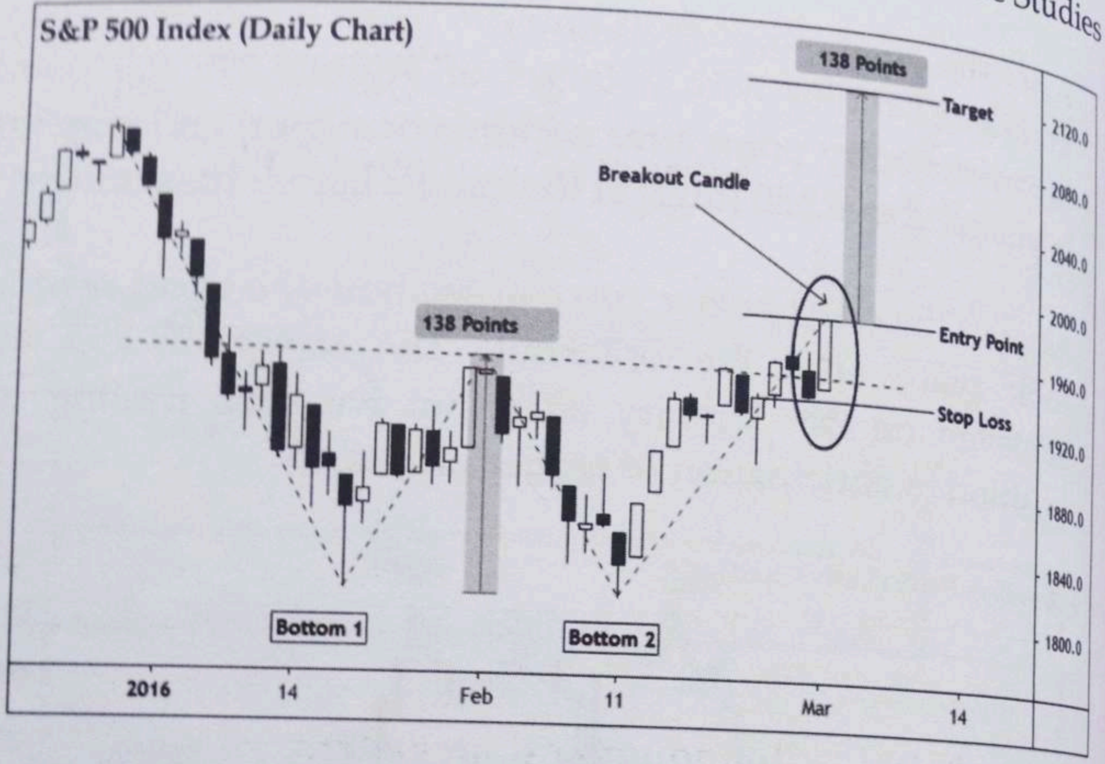
Now in the chart below you can see how the trend reversal took place after the breakout. The target of 299 was achieved on 28th January 2021. But we keep trailing our position in anticipation of higher profits.



Unfortunately trailing stop loss gets hit on the next day and we exit the trade around 315, making a profit of over Rs. 45 per share. In such a scenario, I am sure many new traders might think, ***Wish I had booked profit yesterday around 300.*** To be successful, a trader should never regret such things.

Case Study 11 : Double Bottom Pattern

A Double Bottom Pattern was formed on the daily chart of S&P 500 Index (US Market) from December 2015 as shown in the chart on the next page.

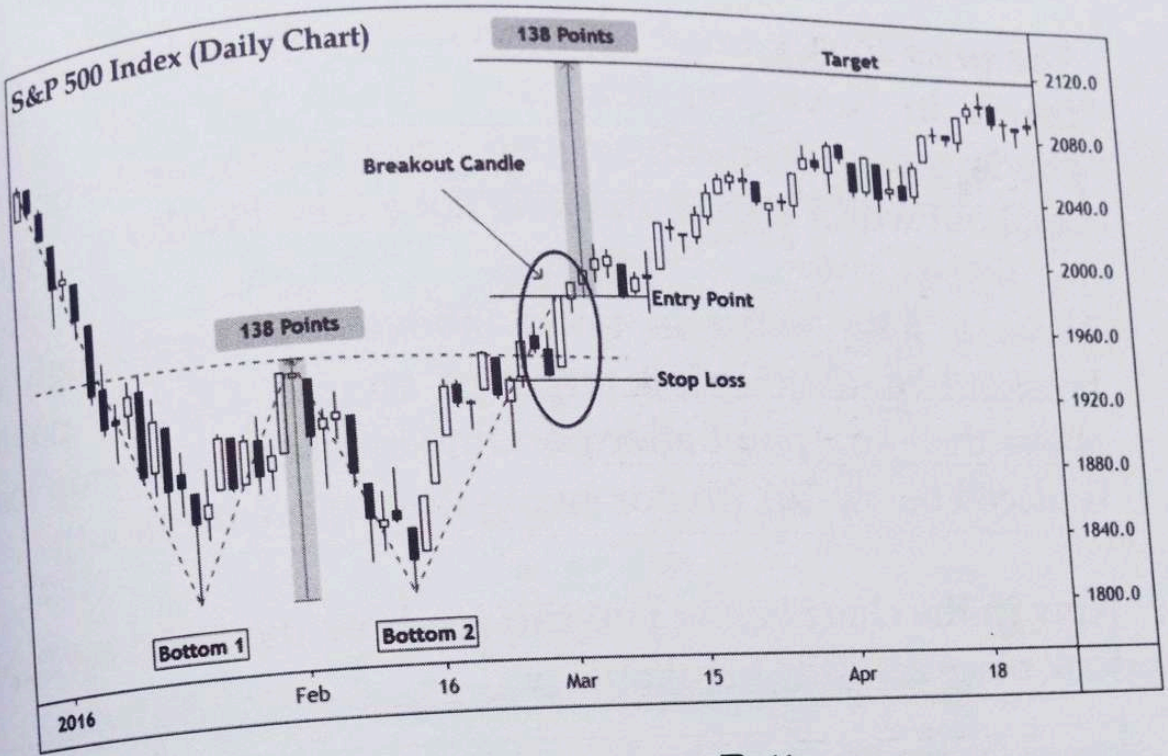


As seen in the chart above, after a long bearish trend, the price formed a 1st bottom followed by a 2nd bottom and then it gave a breakout with Bullish Marubozu - a very strong bullish candle.

After this strong breakout, a long entry is taken above 1978 (high of breakout candle) with a target of around 2116 (138 points above the entry point after neckline breakout) and stop loss is placed below 1931 (minor swing low before breakout).

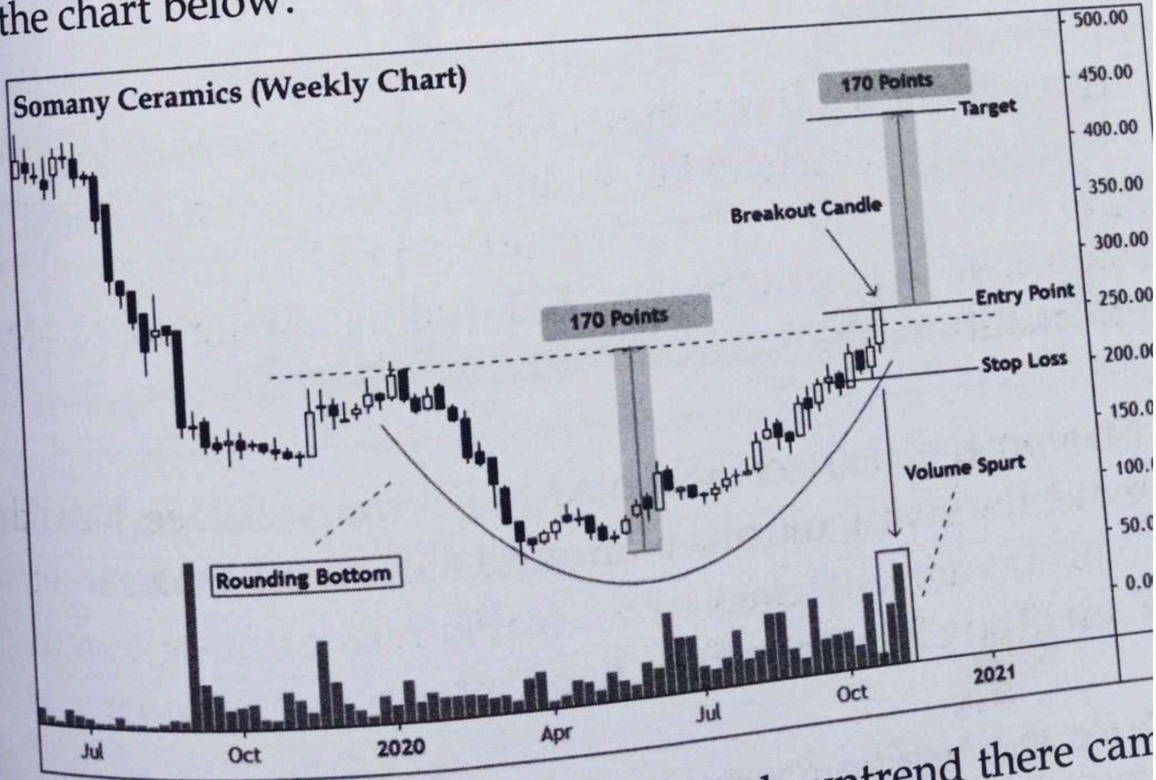
Now in the chart on the next page, you can see how the trend reversal took place after the breakout. The target of 2116 was almost achieved with SPX Index hitting a high of 2111.10 on 20th April 2016.

After the breakout, the index moved from 1950 to 2110 which is around 8% upside move.



Case Study 12 : Rounding Bottom Pattern

A Rounding Bottom Pattern was formed on the weekly chart of Somany Ceramics from December 2019 as shown in the chart below.

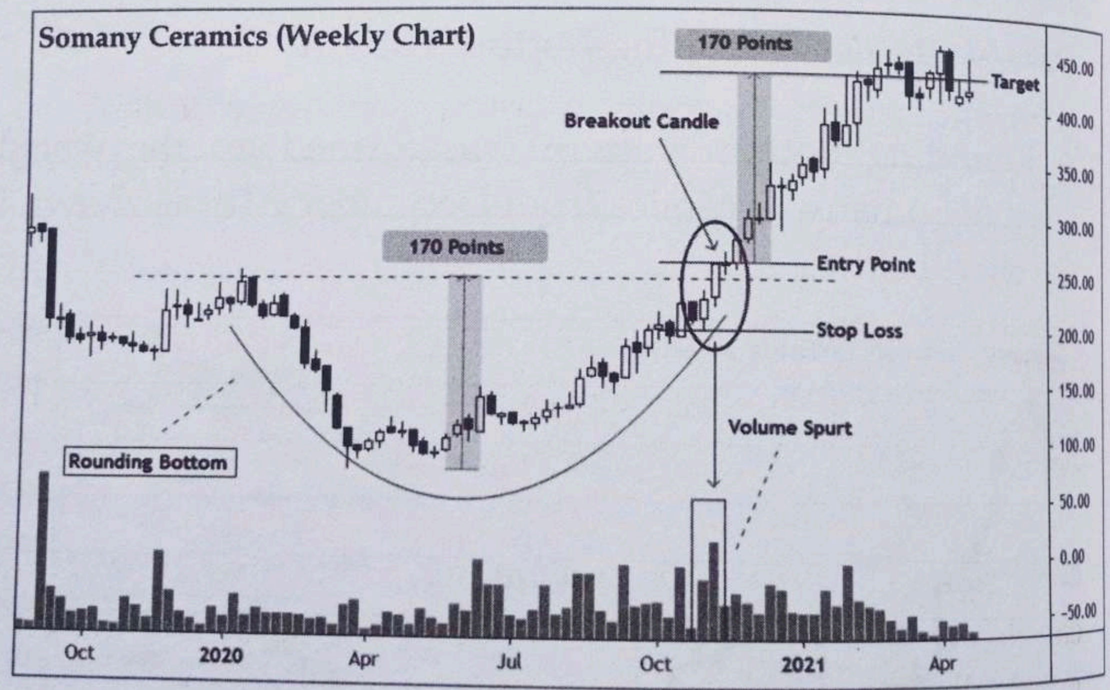


As seen in the chart above, after a downtrend there cam period of consolidation. During this period the fall in price got slowly arrested, a bottom was formed and t price slowly started rising.

The price finally breaks the neckline with a strong bullish candle in November 2020, as seen in the chart on the previous page. You can notice a huge volume at the time of breakout which signals that it is not a false breakout.

Now, a long entry is taken above 260 level (high of breakout candle) with a target of around 430 (170 points above the entry point after neckline breakout) and stop loss is placed below 201 (minor swing low before breakout).

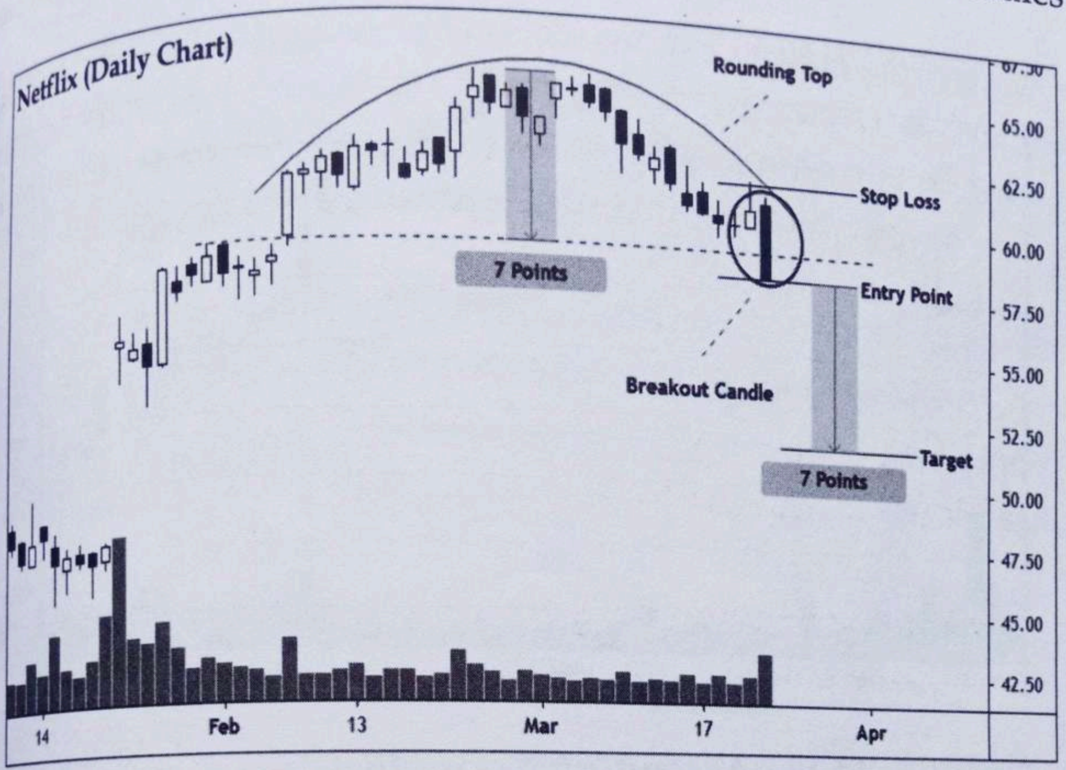
Now in the chart below you can see how the trend reversal took place after the breakout.



The target of 430 was achieved in February 2021 in less than 4 months giving returns of around 65% to the traders.

Case Study 13 : Rounding Top Pattern

A Rounding Top Pattern was formed on the daily chart of Netflix from the start of February 2014 as shown in the chart on the next page.



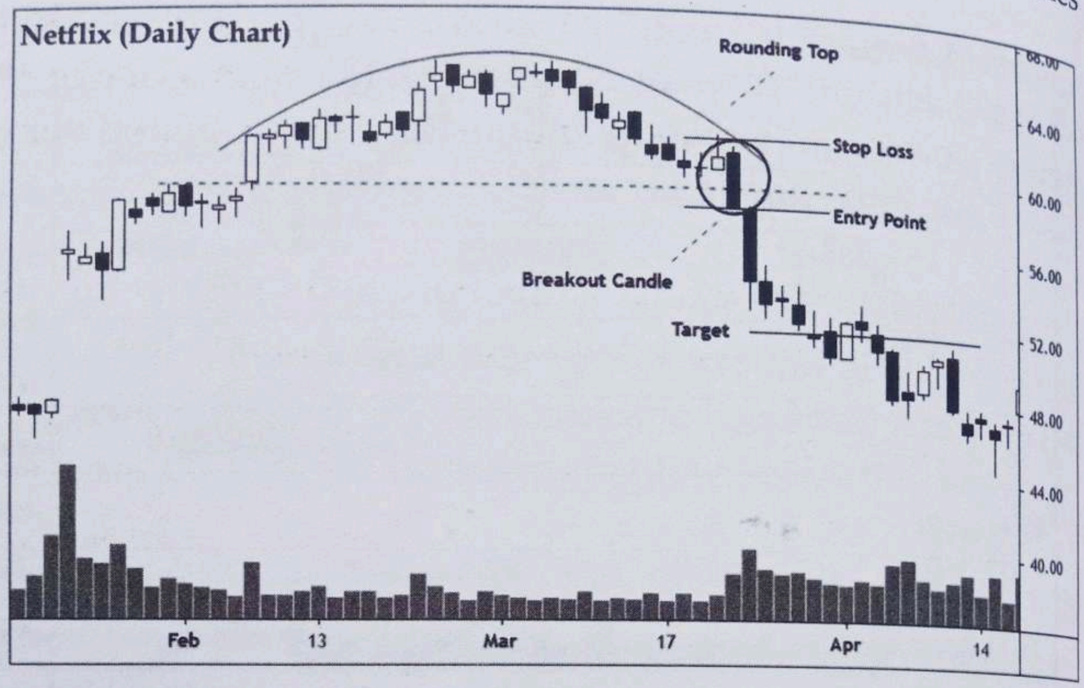
After forming a top, the price slowly starts falling and finally breaks the neckline on 21st March 2014 with a strong bearish candle as seen in the chart above.

You can also notice that breakout occurred on volume higher than the average volume of the past few days. This signals that the breakout can be a real one.

Now, a short entry is taken below 57.96 (low of breakout candle) with a target of around 51 (7 points below the entry point after neckline breakout) and stop loss is placed above 61.74 (minor swing high before breakout).

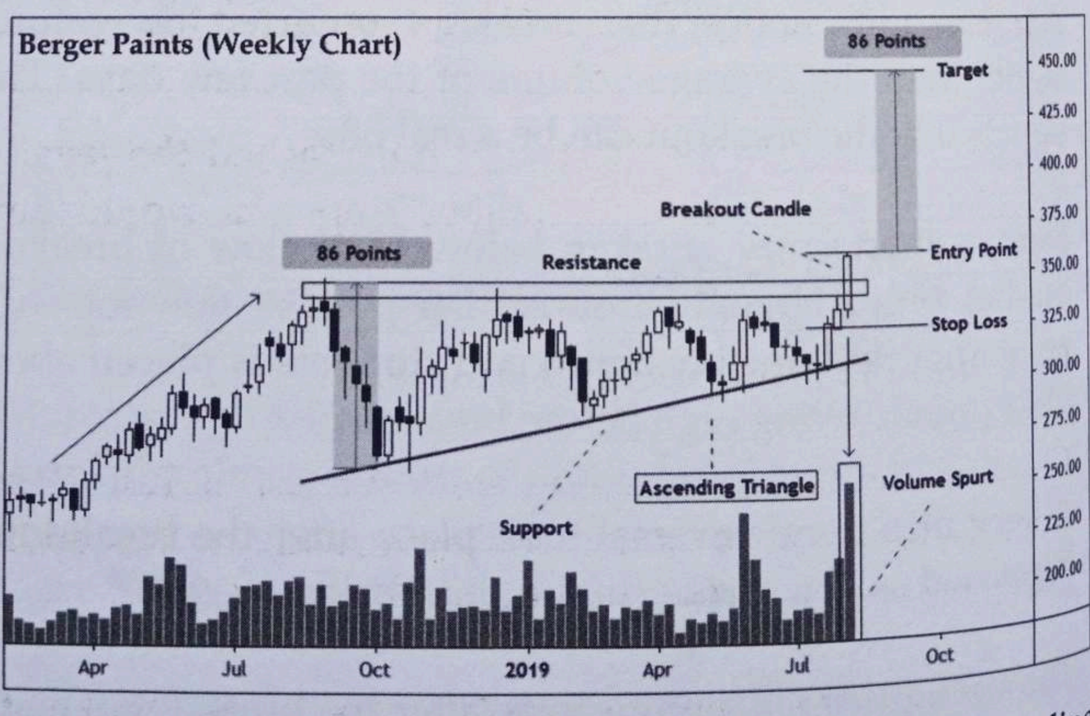
A very nice trend reversal took place after the breakdown happened as you can see in the chart below.

The stock price fell significantly after the breakdown and it went all the way down to the level of 45.



Case Study 14 : Ascending Triangle

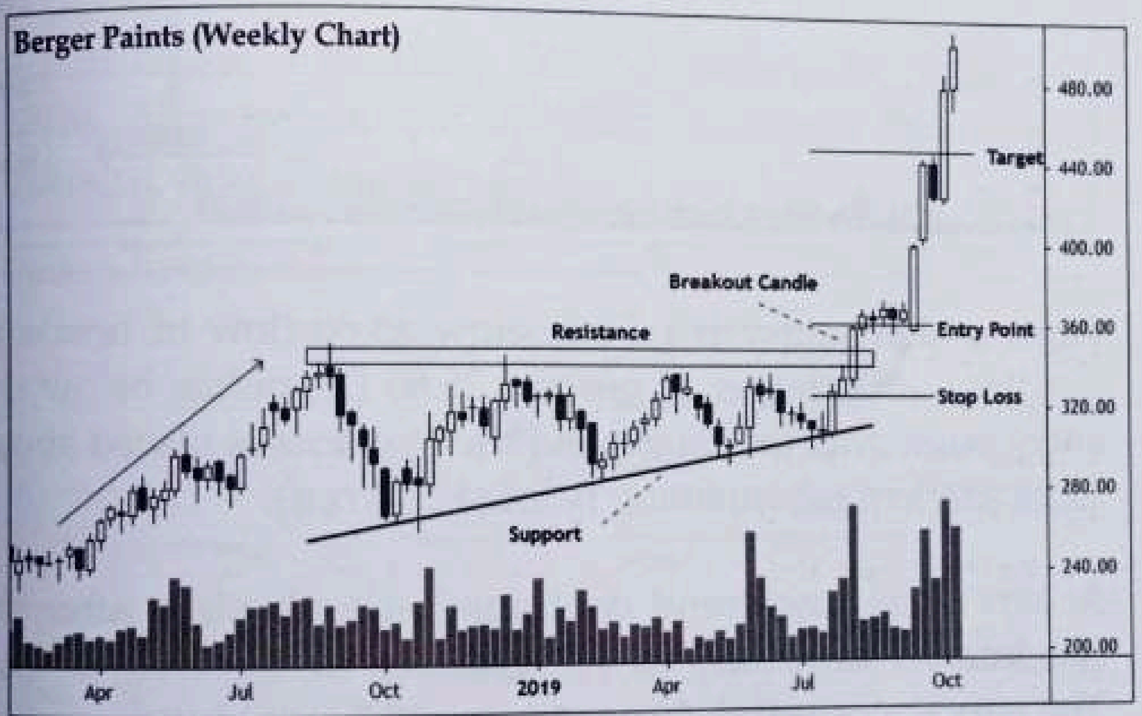
Chart below is the weekly chart of Berger Paints from February 2018. After an uptrend, an Ascending Triangle pattern started forming from August 2018.



Finally on 5th August 2019, the stock broke the ascending triangle pattern with a strong bullish candle having a huge volume which made the breakout more reliable.

Now, a long entry is taken above 361 (high of breakout candle) with a target of around 447 (86 points above the entry point after breakout) and the stop loss is placed below 325 (low of the previous candle).

A very nice uptrend continuation took place after the breakout happened as you can see in the chart below.

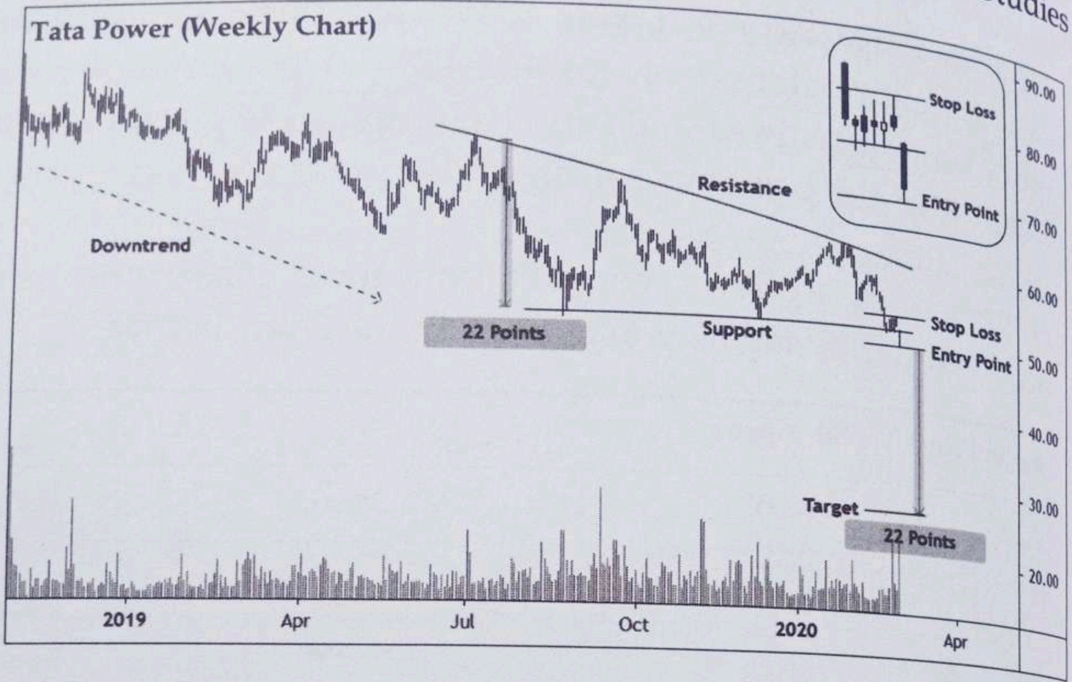


The stock not only hit the target but reached the level of 500. People who followed trailing stop loss would have easily made a higher profit.

Case Study 15 : Descending Triangle

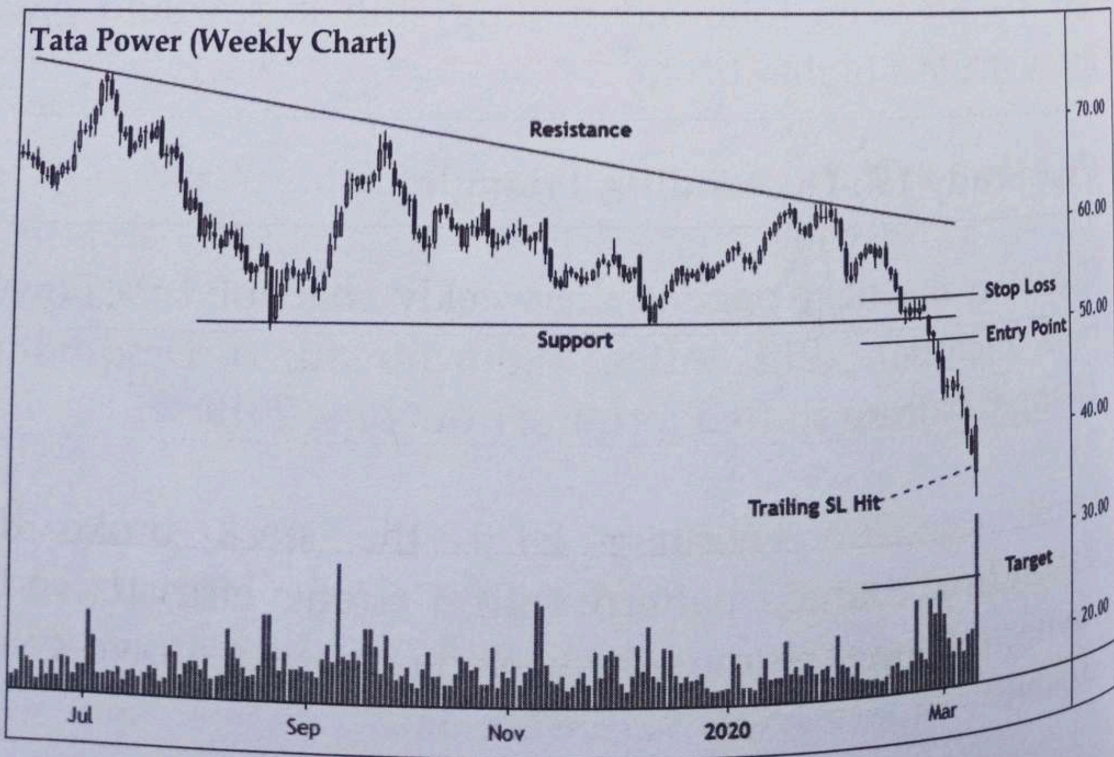
Chart on the next page is the weekly chart of Tata Power from October 2018. After a downtrend, a Descending Triangle pattern started forming from June 2019.

Finally on 26th February 2020, the stock broke the descending triangle pattern with a strong bearish candle having a huge volume which made the breakdown more reliable.



Now, a short entry is taken below 48.80 (low of breakout candle) with a target of around 26.80 (22 points below the entry point after breakout) and the stop loss is placed above 52.95 (high of minor swing before breakout).

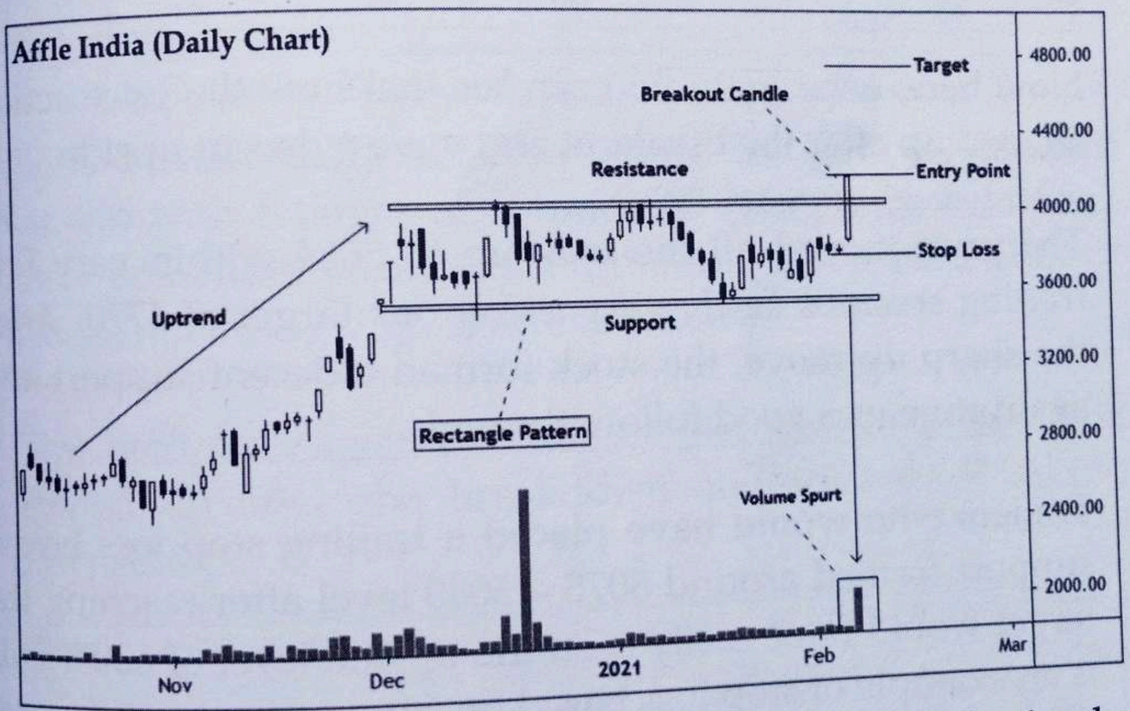
A very nice downtrend continuation took place after the breakdown happened as you can see in the chart below. The stock corrected from 48 to 37.8 in just 9 trading sessions.



The next day on 12th March 2020, the stock opened lower and hit a low of 33.85 before starting to rise and that too on good volumes. This is when your trailing stop loss would get hit around 38 – 39 level. Still a good profit of around 20% in 10 trading sessions.

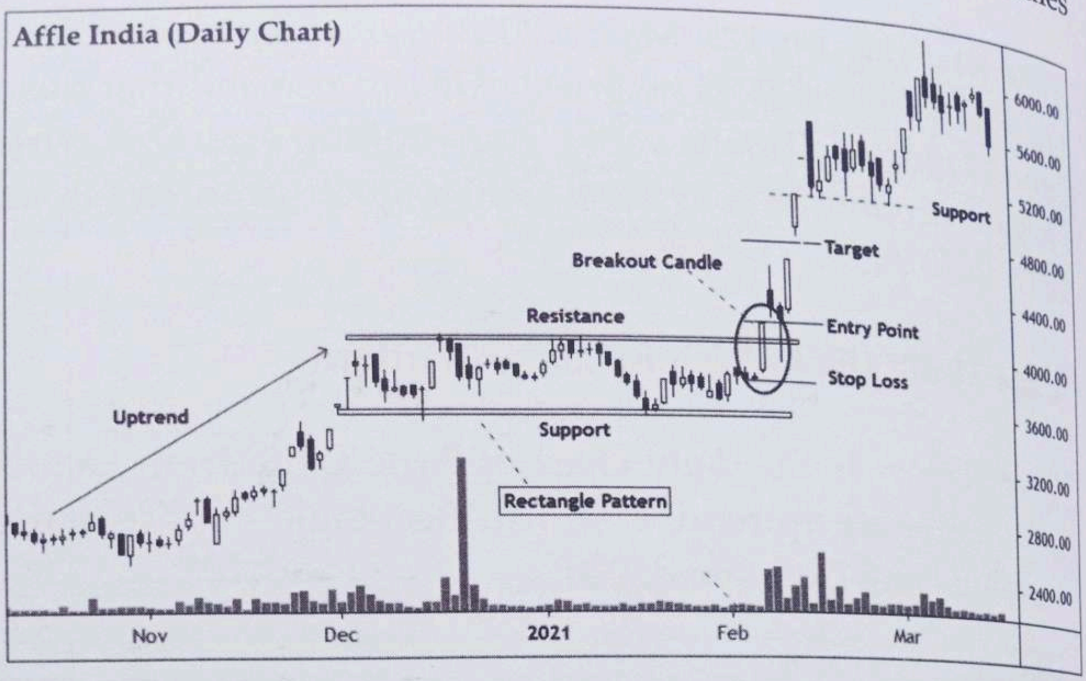
Case Study 16 : Bullish Rectangle Pattern

Chart below is the daily chart of Affle India from October 2020. After an uptrend, a Bullish Rectangle Pattern started forming from December 2020.



After two months, on 5th February 2021 the stock broke the bullish rectangle pattern with a very strong bullish candle. This breakout happened on huge volume which made the breakout more reliable, indicating that the uptrend would continue further.

Now, a long entry is taken above 4175 (high of breakout candle) with a target of around 4770 (595 points above the entry point after breakout) and the stop loss is placed below 3770 (minor swing low before breakout).



Now here, once again you can see that how the price action shaped up after the breakout and gave a decent upside.

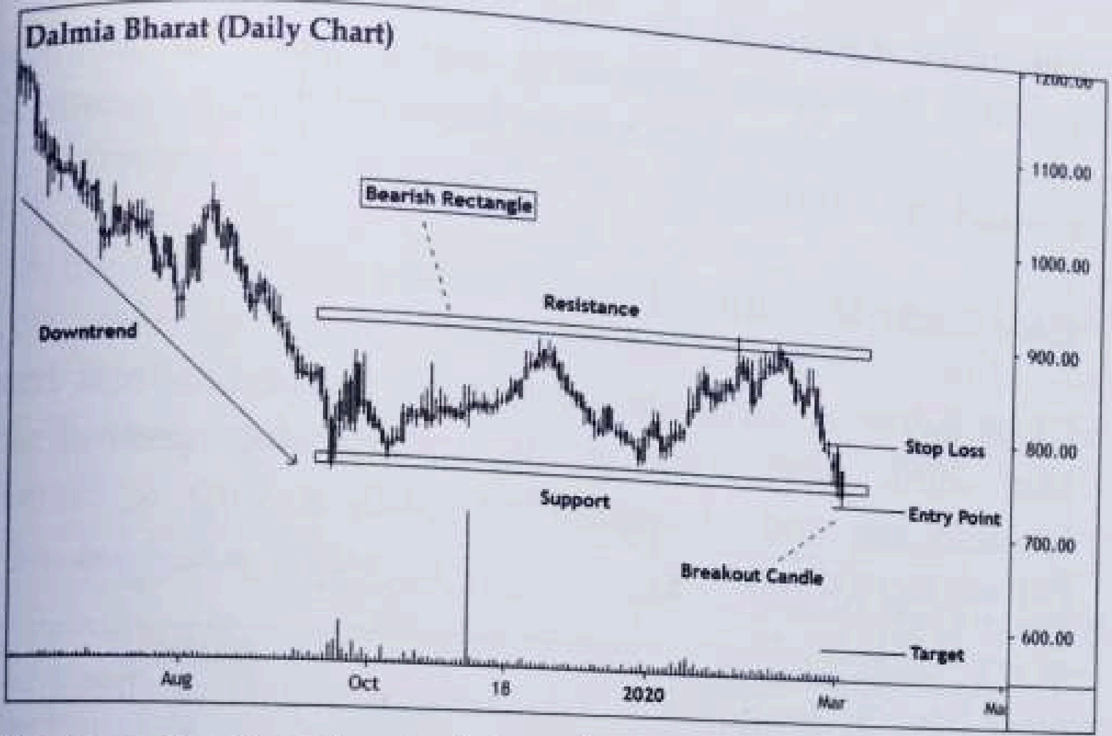
The price moved all the way up to 5614 within very few trading sessions easily surpassing our target of 4770. After the sharp up move, the stock formed a decent support and again gave us a good follow through.

Traders who would have placed a trailing stop loss below support formed around 5075 – 5080 level after reaching the target would have easily seen the upside level of 6000. This is an example of stop loss based on support.

Case Study 17 : Bearish Rectangle Pattern

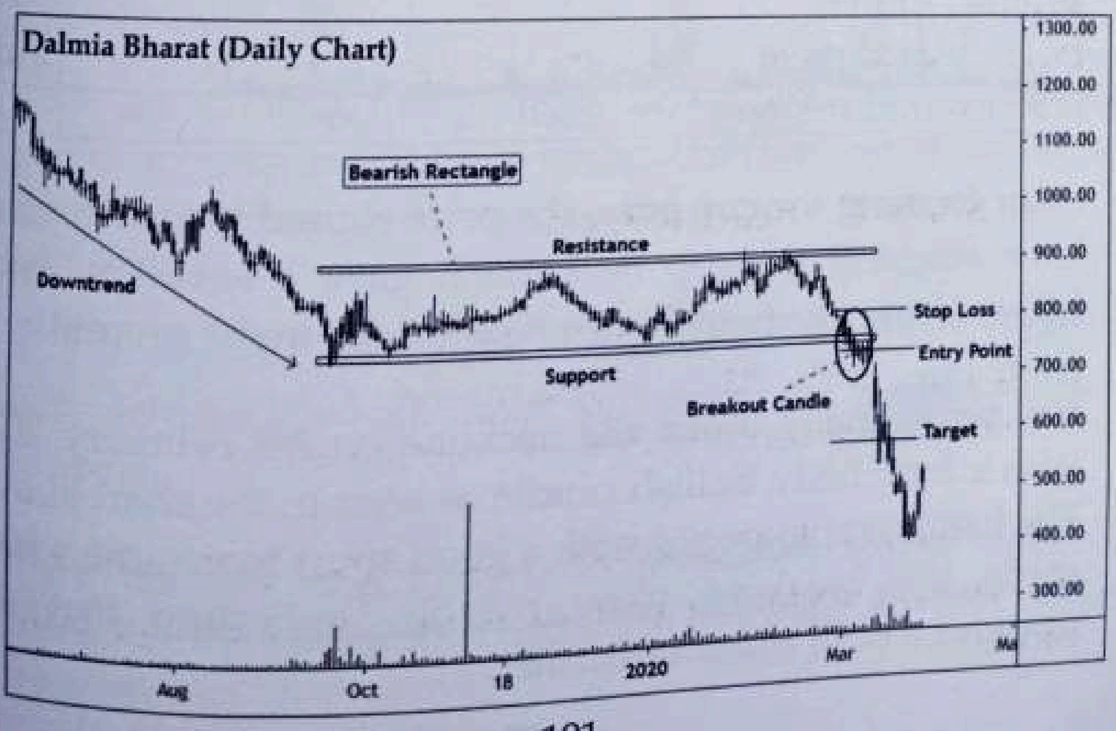
Chart on the next page is the daily chart of Dalmia Bharat from June 2019. After a downtrend, a Bearish Rectangle Pattern started forming from September 2019.

After five and half months, on 3rd March 2020 stock broke the bearish rectangle pattern with a very strong bearish candle.



Now, a short entry is taken below 740 (low of breakout candle) with a target of around 580 (160 points below the entry point after breakout) and the stop loss is placed above 808 (minor swing high before breakout).

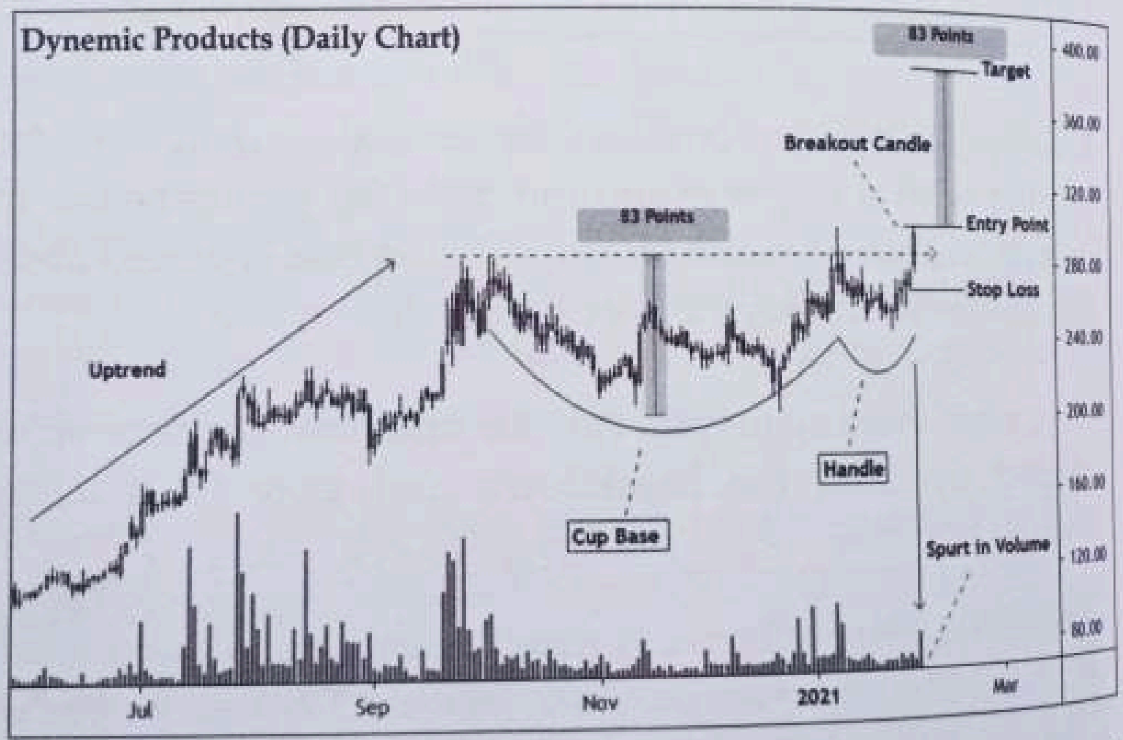
Now here, once again you can see that how the price action shaped up after the breakdown and gave us a decent downside.



The price moved all the way down to 402 in less than a month's time easily surpassing our target of 580. A trader using a tailing stop loss would have easily got a good exit around 480 – 500 levels.

Case Study 18 : Cup & Handle Pattern

Chart below is the daily chart of Dynemic Products from May 2020. After forming an uptrend top around 285 towards the end of September 2020, a Cup & Handle Pattern started forming.

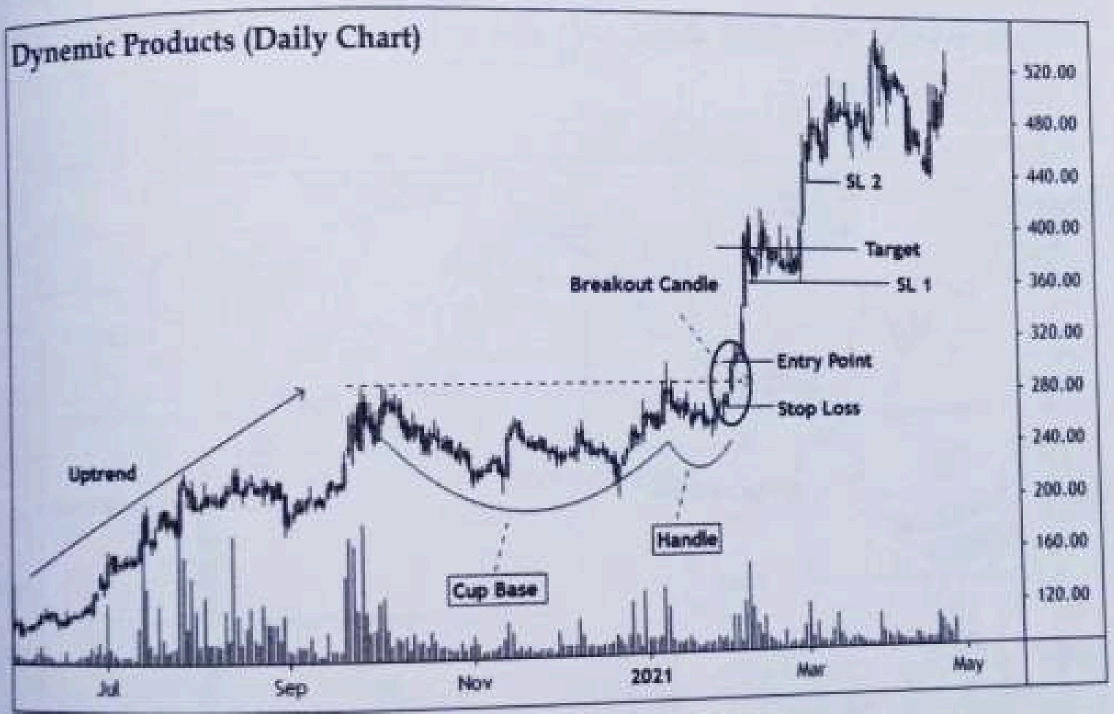


After forming the cup base, the price started increasing and later reaching the cup neckline it gave a small pullback before rising again, making a nice handle in the process.

The price finally broke the neckline on 2nd February 2021 with a long body bullish candle as seen in the chart above. The breakout happened with a good spurt in volume which made the breakout more reliable, indicating that the uptrend would continue further.

Now, a long entry is taken above 300 (high of breakout candle) with a target of around 383 (83 points above the entry point after breakout) and the stop loss is placed below 266 (minor swing low before the breakout).

In the chart below you can see how the price action shaped up after the breakout and gave us a decent upside. The stock zoomed from 300 to 396 in just 4 trading sessions achieving the target.



Now as advised many times before, instead of booking profit, a trader could have trailed the stop loss as shown in the image below.

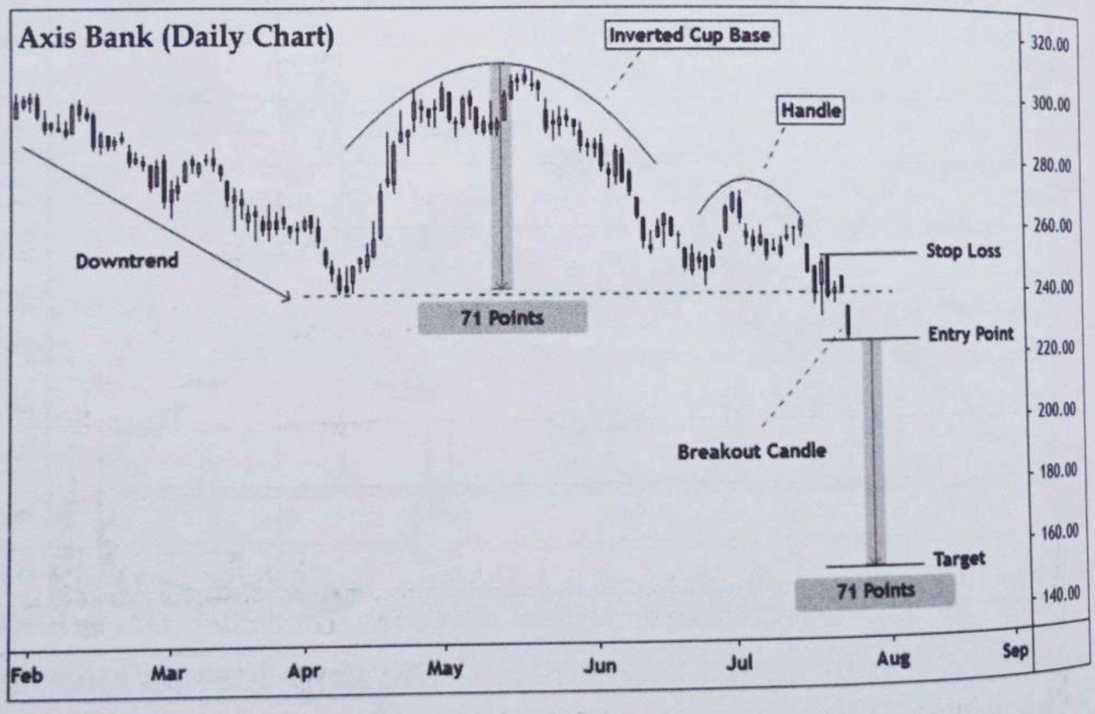
SL 1 is placed at the swing low made 2 days after the target was achieved which later on acted as good pullback support.

Later on, this stop loss could be trailed higher to SL 2 placed at the swing low formed a day after another sharp up move.

This stop loss strategy is based on the concept of support which was explained earlier in the book. But such an approach requires experience and hence beginners can use the simple trailing stop loss strategy which is explained earlier i.e., trailing the initial stop loss.

Case Study 19 : Inverted Cup & Handle Pattern

Chart below is the daily chart of Axis Bank from January 2013. After forming a downtrend bottom around 240 in the first week of April 2013, an Inverted Cup & Handle Pattern started forming.



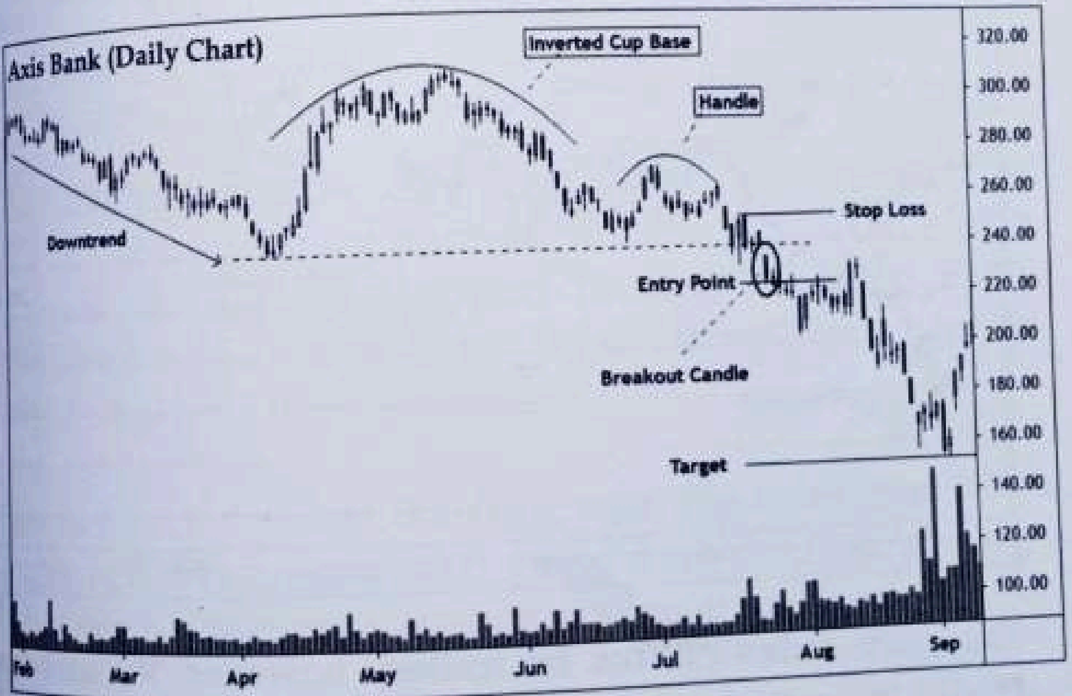
After forming the base of an inverted cup, the price started falling and later reaching the neckline it gave a small pullback before falling again making a nice handle in the process.

On 23rd July 2013, the stock opened gap down breaking the neckline and ended the day with a strong bearish candle.

Now, a short entry is taken below 224 (low of breakout candle) with a target of around 153 (71 points below the entry point after breakout) and the stop loss is placed above 250 (minor swing high before breakout).

In the chart below you can see how the price action shaped up after the breakdown and gave us a decent downside after consolidating around the entry price for few days.

The stock declined from 224 to make a low of 152.70 before reversing its direction. Target got achieved.



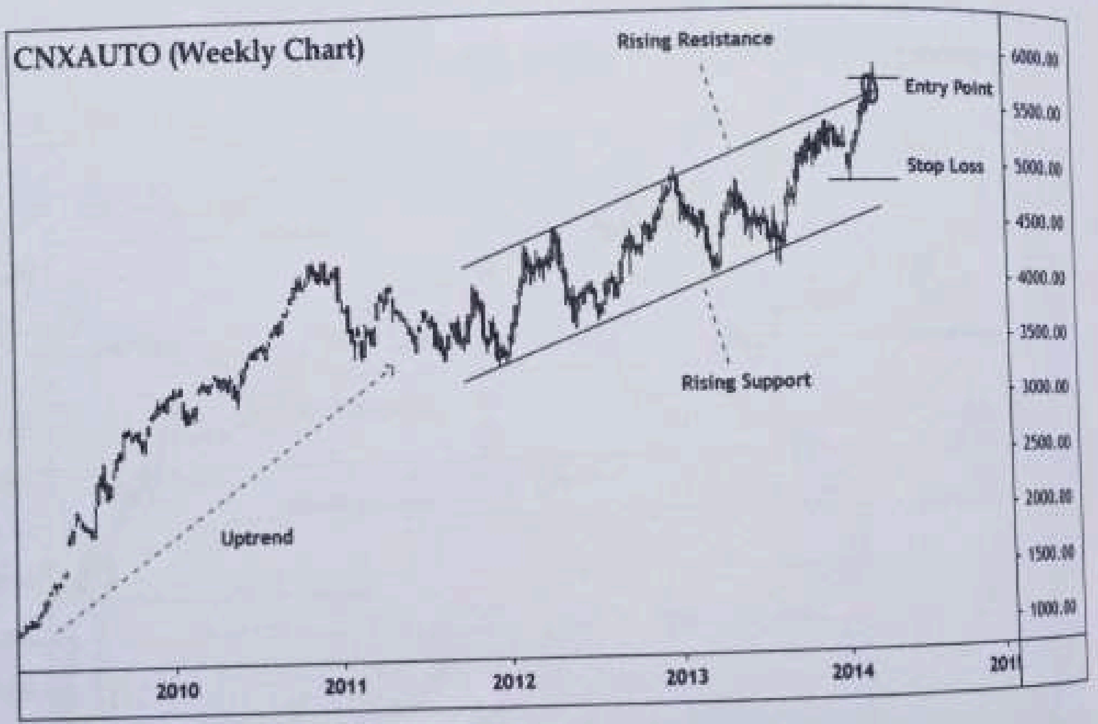
Now watch the candle formation when the target was achieved. After forming a long body bearish candle on 3rd September 2013, next day the price opened higher than the previous day's close and tried to go lower but could not go much below the previous day's low and started rising.

This gave a clear indication of reversal on cards and this can be a good alarm for short sellers to square off their positions and book profits somewhere around 160.

Case Study 20 : Rising Channel (Continuation)

Chart below is the weekly chart of Nifty Auto (CNX Auto) from January 2009. After an uptrend, a rising channel pattern started forming from December 2011 onwards.

In the last week of March 2014, the price gave a breakout on the upside confirming the continuation of the previous uptrend.

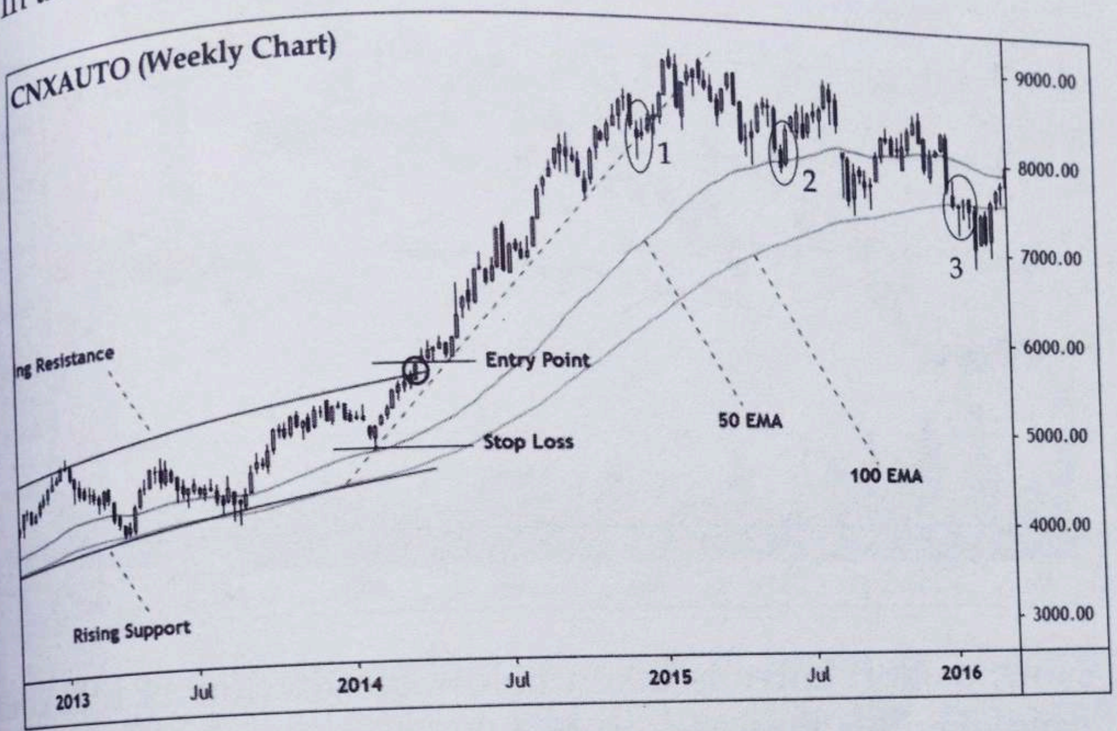


The auto index cannot be traded, however, it can help a trader to create long positions in auto stocks, especially the ones having heavy weightage in that index.

Now for our analysis, long entry is considered above 5763.30 (hight of breakout candle) and stop loss is placed below 4858 (minor swing low before breakout).

It is important to note that in this case our view is for longer term and not for short or medium term and hence we use a bit wider stop loss.

In the chart below you can see what happens ahead.



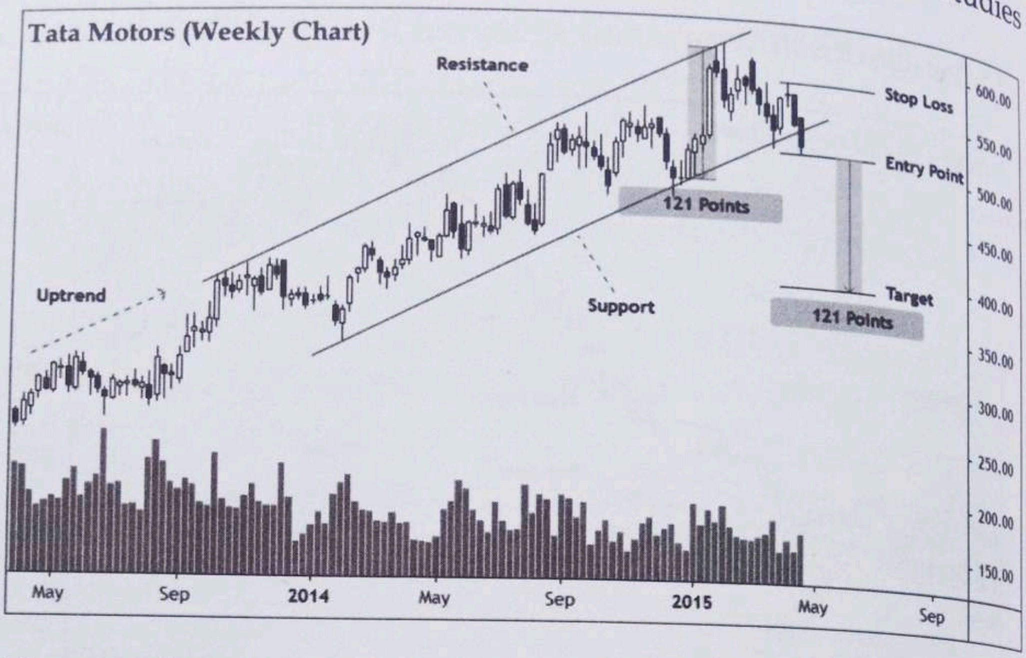
Now the exit criteria may vary from one investor to another. Below I have shown three exit criteria which investors can use – 1. Support Breakdown, 2. 50 EMA Breakdown and 3. 100 EMA Breakdown. There can be several other long term exit criteria.

Now in a period of less than one year, the index rose from levels of 5600 to around 8000 + and during this time many frontline auto stocks who have scaled new highs.

Case Study 21 : Rising Channel (Reversal)

Chart on the next page is the weekly chart of Tata Motors from April 2013. After an uptrend, a rising channel pattern started forming from October 2013.

After being stuck in the channel for around 18 months, in the week starting 20th April 2015, the price gave a breakout on the downside confirming the reversal from the previous uptrend.

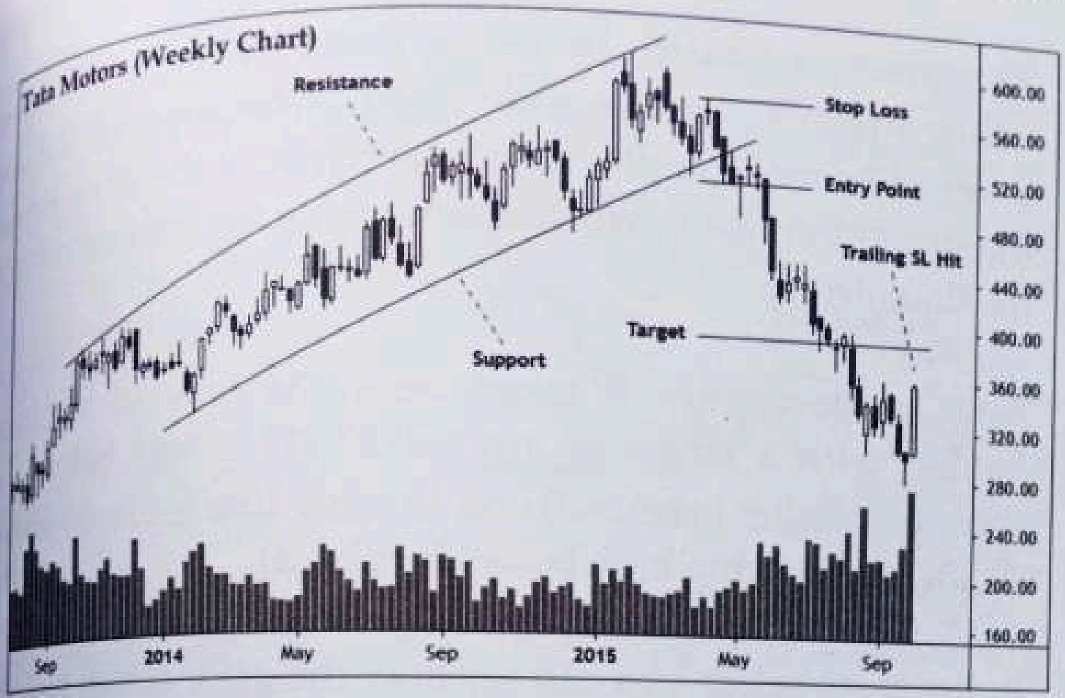


Now, a short entry is taken below 508.45 (low of breakout candle) with a target of around 387.45 (121 points below the entry point after breakout) and the stop loss is placed above 573.50 (minor swing high before breakout).

Now in this case, since the pattern has given a long term breakout after around 18 months we can expect a good downside and hence in such cases one should take a medium term positional view.

Also, the stop loss in this case is bit wider one, so it is advisable for a trader to take a smaller trading position based on the size of his trading capital.

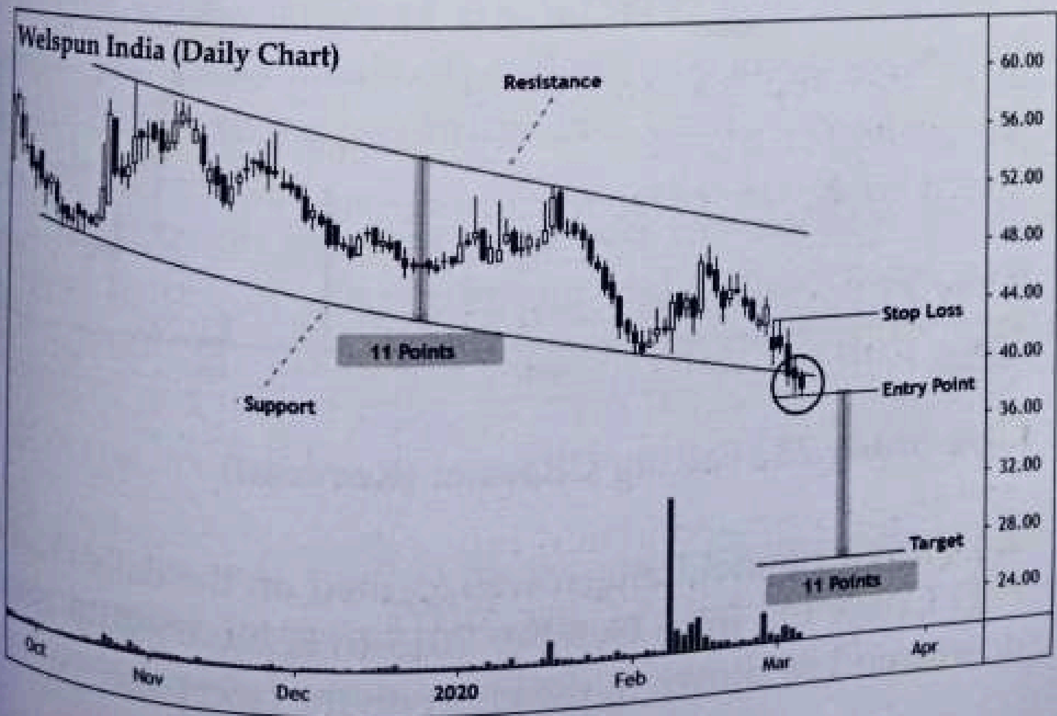
Now in the chart on the next page, we shall see how the trade pans out. After entering the short trade, the price tries to bounce a bit but fails to cross the support trendline which now acts as resistance and then starts falling. The target of 387.45 got achieved in mid July 2015, but rather than exiting we keep trailing our short position.



A few weeks later in the last week of September 2015, the stock hits a new low of 279.10 and then the price starts rising. Trading stop loss gets triggered around 345 and the trader exits the position.

Case Study 22 : Falling Channel (Continuation)

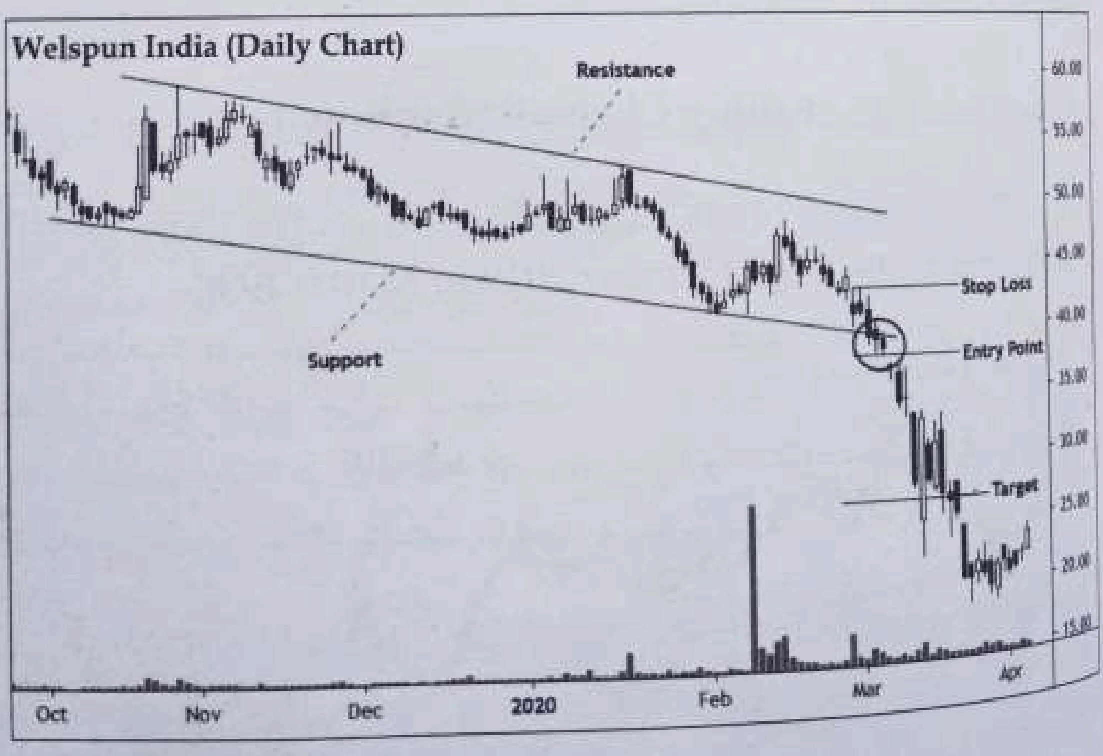
A Falling Channel Pattern was formed on the daily chart of Welspun India from October 2019 to March 2020.



The price continued to move lower swinging between falling upper resistance and falling lower support. After a series of bearish candles on 5th March 2020 the stock broke the support on the downside confirming the continuation of the downtrend.

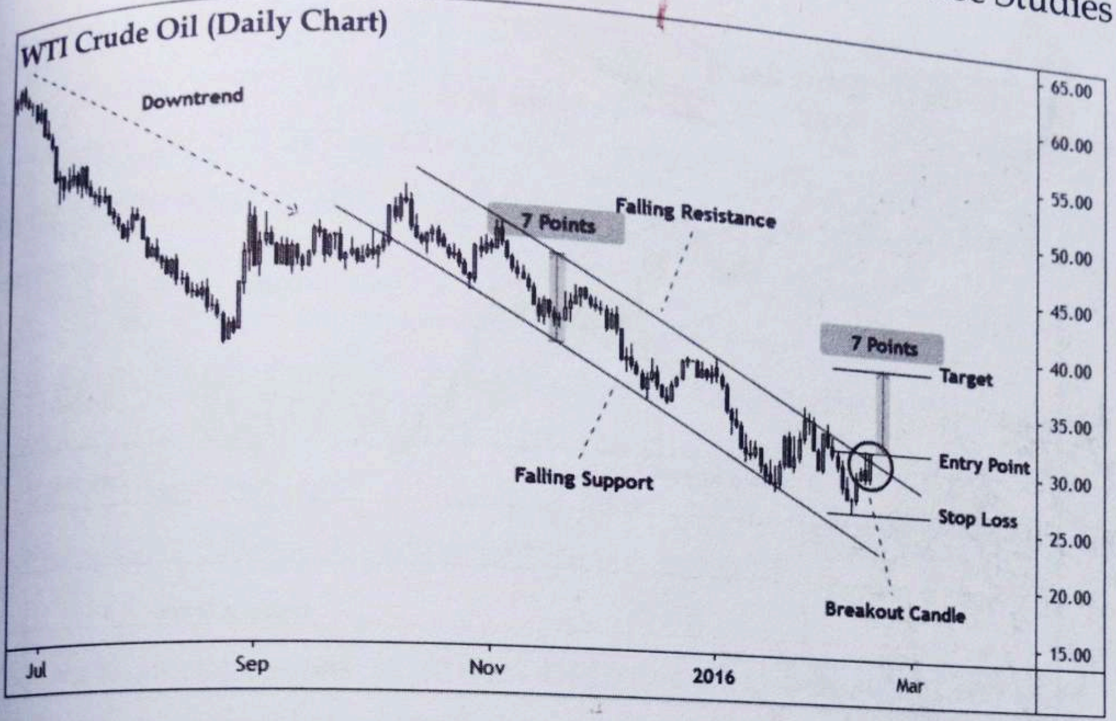
Now, a short entry is taken below 38 (low of breakout candle) with a target of around 27 (11 points below the entry point after breakout) and the stop loss is placed above 43.20 (minor swing high before breakout).

In the chart below you can see how the price action shaped up after the breakdown and gave us a decent downside. The stock crashed and hit a low of 22.40 in just 5 trading sessions easily achieving the target.



Case Study 23 : Falling Channel (Reversal)

A Falling Channel Pattern was formed on the daily chart of WTI Crude Oil from October 2015 to February 2016 after a downtrend as shown in the chart on the next page.



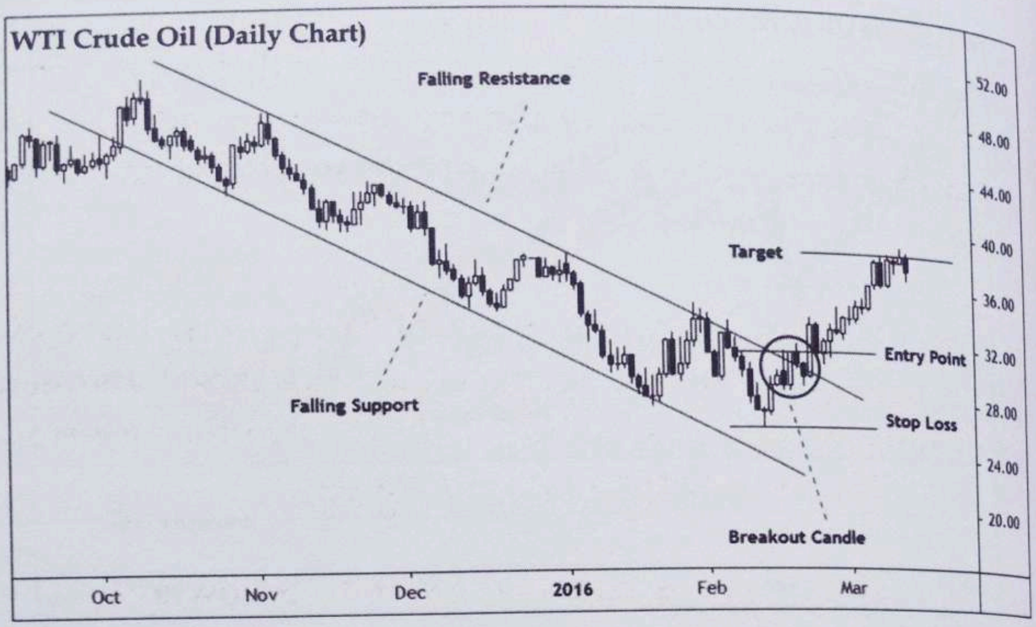
The price continued to move lower swinging between the falling upper resistance and the falling lower support, correcting from 50 odd levels to the level of 26.

On 17th February 2016, the price broke the upper resistance forming a strong bullish candle confirming the reversal of the previous downtrend.

Now, a long entry is taken above 31.41 (high of breakout candle) with a target of around 38.41 (7 points above the entry point after breakout) and the stop loss is placed below 26.08 (minor swing low before breakout).

In the chart on the next page you can see how the price action shaped up after breakout and gave a decent upside. The target of 38.41 was achieved in around 14 trading sessions and then it failed to cross the level of 38.50 for six days and hence it is advisable to book profits.

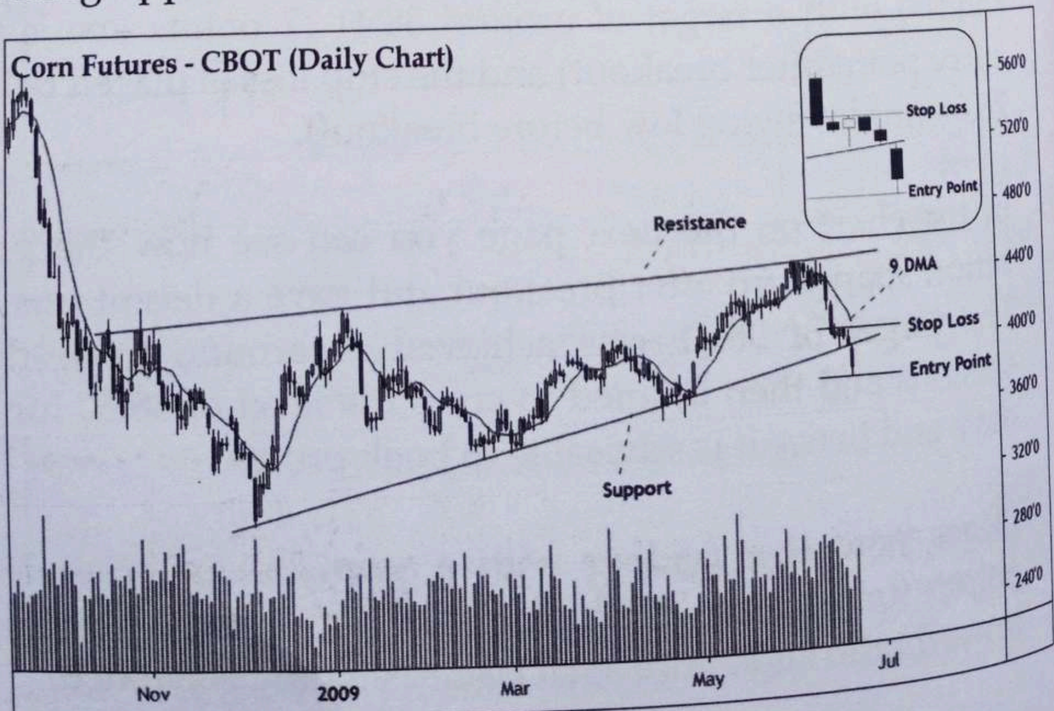
Please note that trading with a stop loss of around 5.5 points for a target of 7 points is not a favourable risk-reward ratio and hence such trades should be avoided.



Case Study 24 : Rising Wedge (Continuation)

A Rising Wedge Pattern was formed on the daily chart of Corn Futures on CBOT Exchange (USA) from September 2008 to June 2009 after a downtrend as shown in the chart below.

The price continued to move higher swinging between rising upper resistance line and rising lower support line.

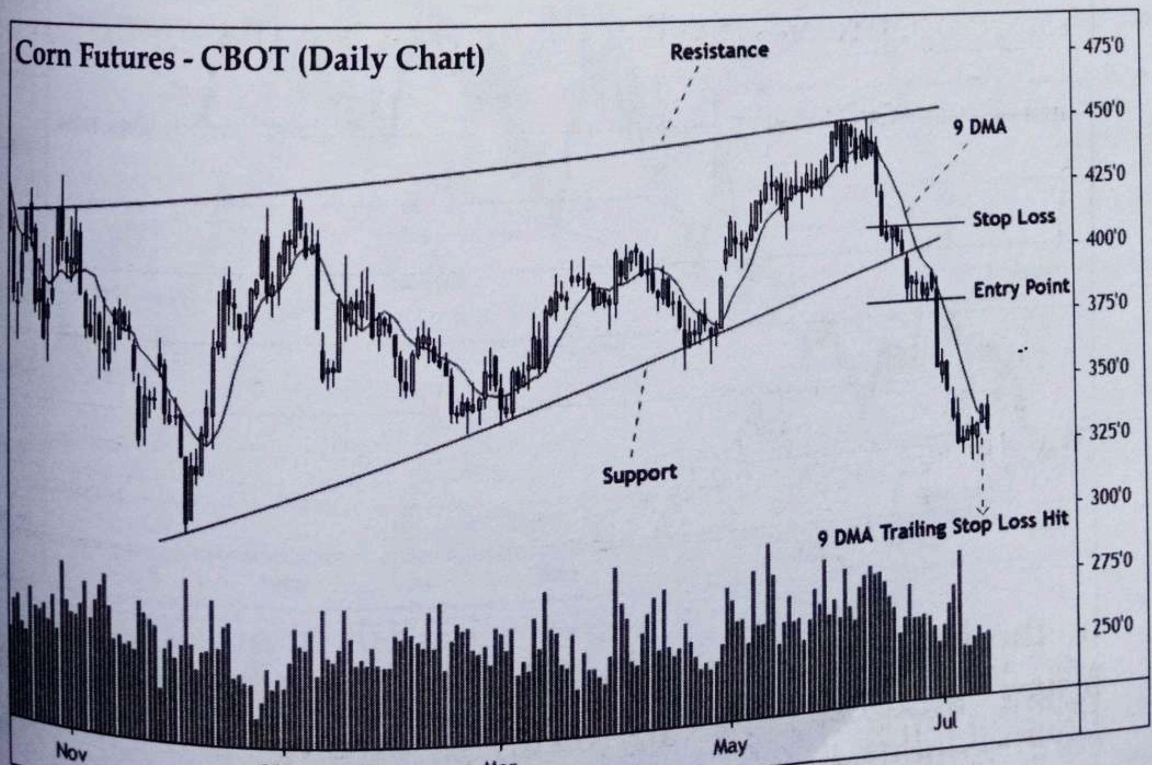


On 22nd June 2009, the price broke the rising lower support line forming a strong bearish candle with higher volume confirming the reversal of the previous uptrend. The price was also below the 9 DMA giving an additional bearish trigger.

As mentioned earlier, in the case of this pattern, there is no measuring technique to estimate the price target and hence it is advised to use a trailing stop loss or other aspects of technical analysis to forecast price targets.

Now, a short entry is taken below 380.0 $ (low of breakout candle) and initial stop loss is placed above 408.6 $ (minor swing high before breakout).

In this case, a trader can use 9 DMA as a trailing stop loss and as long as the price is below 9 DMA he can hold onto his position. The moment, price breaks the 9 DMA (on the closing basis) on the upside then he should close his trading position.



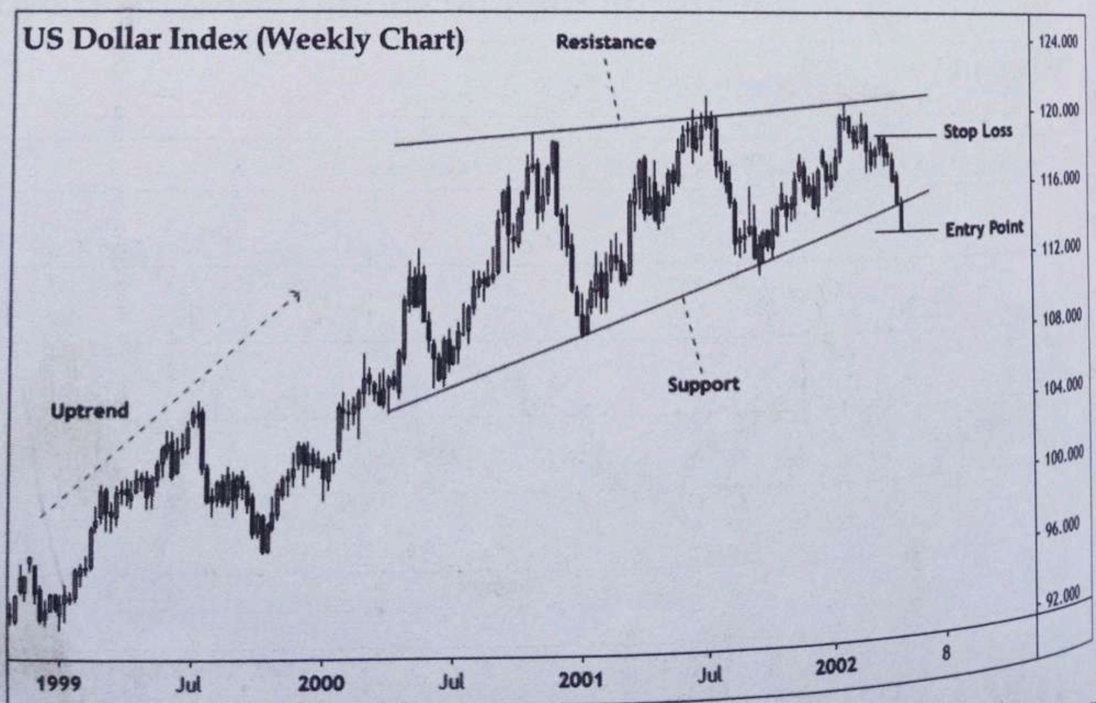
After the breakdown, a good down move was seen and the price of Corn Futures hit a low of 318.4 \$ on 10th July 2009 and then started rising.

Two back to back bullish candles were formed indicating a reversal. Then on 14th July 2009 price closed above 9 DMA and hence trader exits his short position on the next trading day around 338 – 339 \$.

Case Study 25 : Rising Wedge (Reversal)

A Rising Wedge Pattern was formed on the weekly chart of the US Dollar Index from April 2000 to April 2002 after an uptrend as shown in the chart below.

The price continued to move higher swinging between the rising upper resistance line and the rising lower support line.



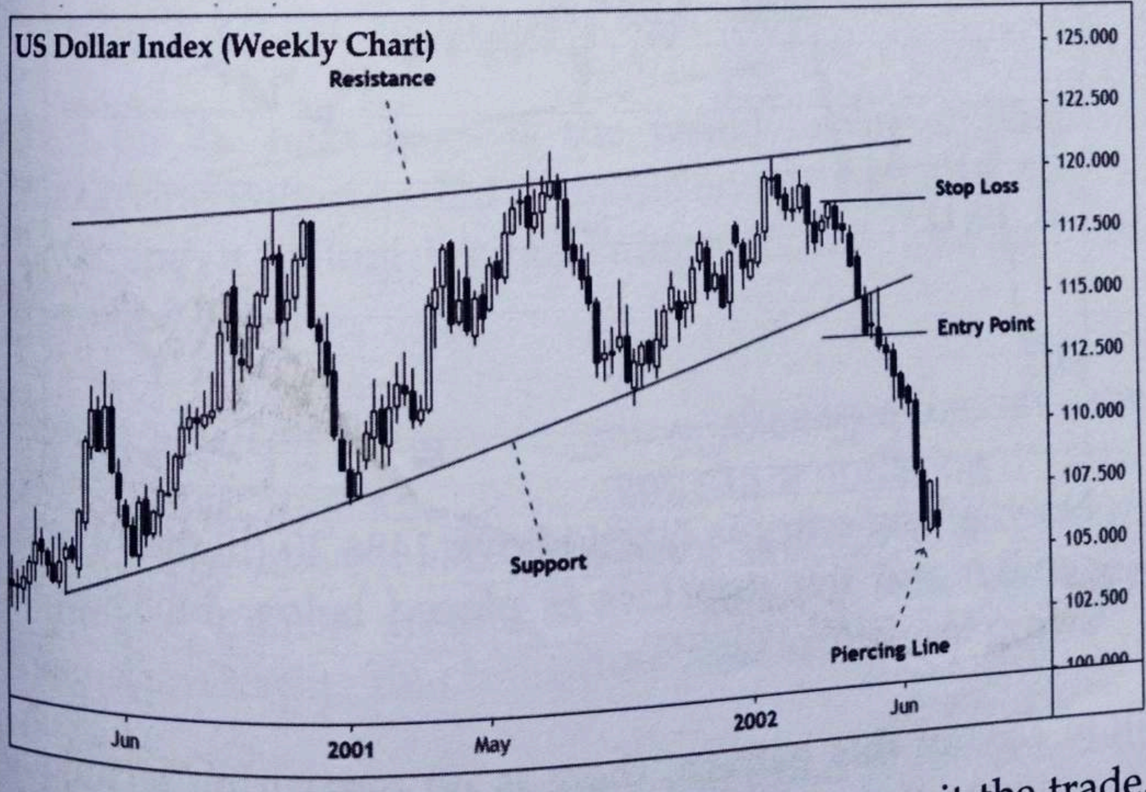
In the last week of April 2002, the price broke the falling lower support line forming a strong bearish candle confirming the reversal of the previous uptrend.

Now, a short entry is taken below 113.500 $ (low of breakout candle) and the stop loss is placed above 118.800 $ (minor swing high before breakout).

As mentioned earlier, in the case of this pattern, there is no measuring technique to estimate the price target and hence it is advised to use a trailing stop loss or other aspects of technical analysis to forecast price targets.

After the breakout, a good down move was seen and the price of the US Dollar Index hit a low of 105.370 in the last week of June 2002 forming a strong bearish candle.

Next week a bullish candle was formed such that a Piercing Line Pattern was formed which indicated a bullish reversal on cards.



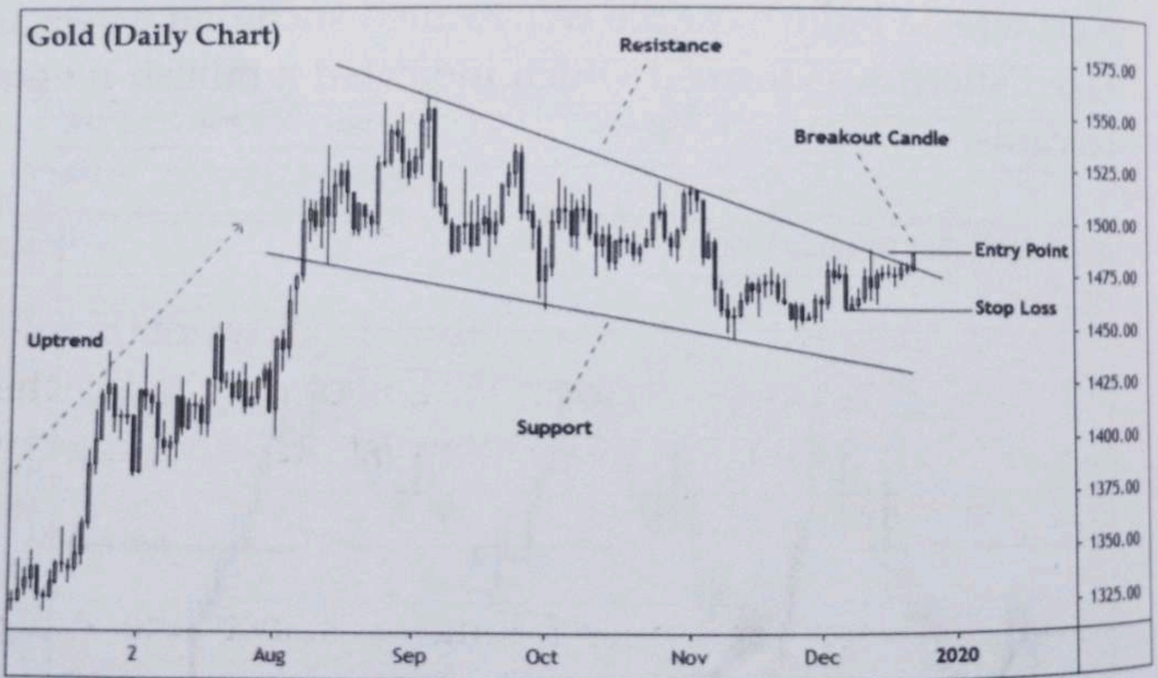
Now looking at the price action, a trader can exit the trade, booking the profit around 107 levels.

Case Study 26 : Falling Wedge (Continuation)

A Falling Wedge Pattern was formed on the daily chart of Gold (US $ / Oz) from August 2019 to December 2019 after an uptrend as shown in the chart below.

The price continued to move lower swinging between falling upper resistance line and falling lower support line.

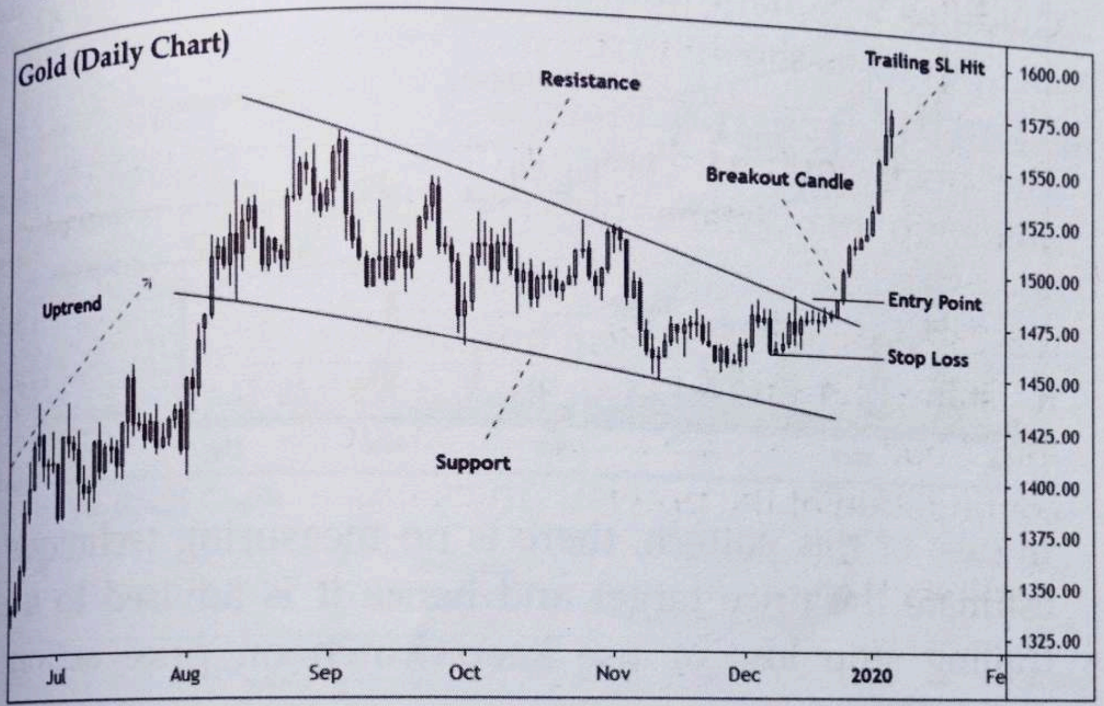
On 23rd December 2019, the price broke the falling upper resistance line forming a strong bullish candle having a long body and very small shadows, confirming the continuation of the previous uptrend.



Now, a long entry is taken above 1486.20 (high of breakout candle) and the stop loss is placed below 1458.85 (minor swing low before breakout).

In case of this pattern, there is no measuring technique to estimate the price target and hence it is advised to use a trailing stop loss or other aspects of technical analysis to forecast price targets.

After the breakout, a good up move was seen and the price of Gold hit a high of 1587.93 on 6th January 2020. The next day the trailing stop loss got triggered around 1560.

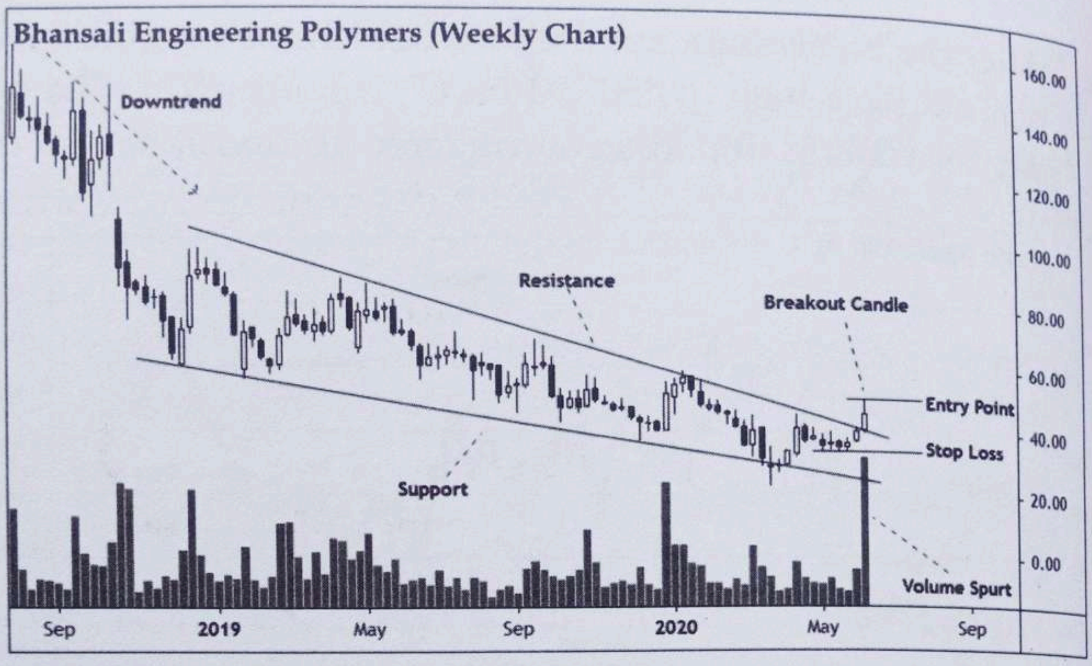


Case Study 27: Falling Wedge (Reversal)

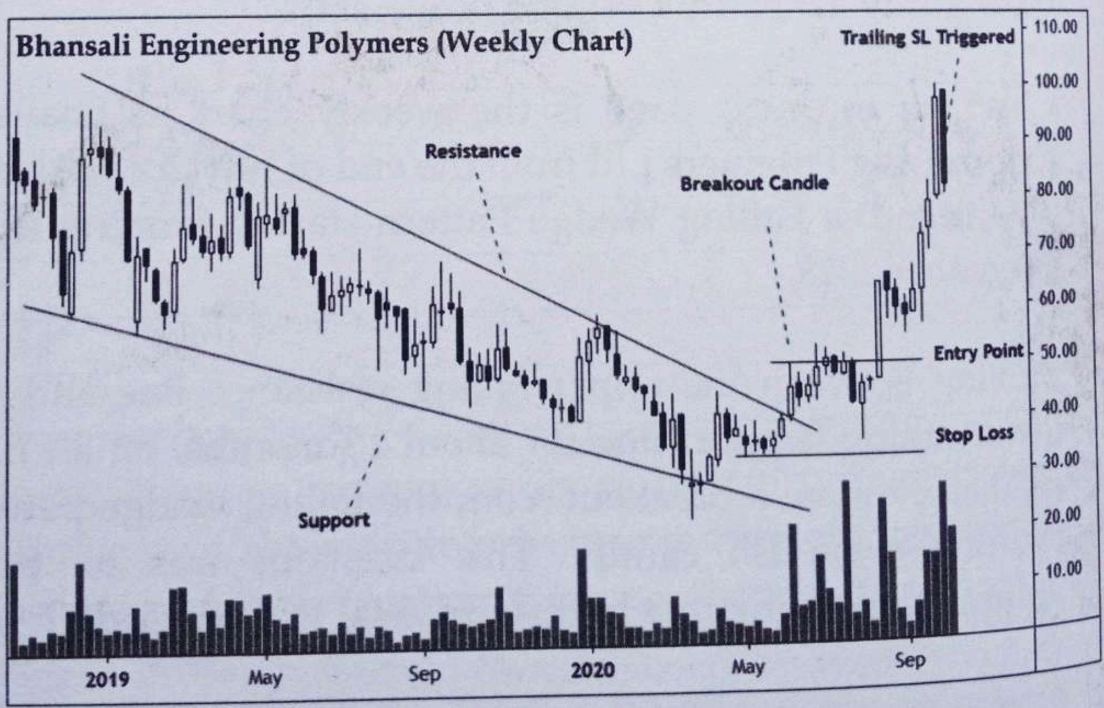
Chart on the next page is the weekly chart of Bhansali Engineering Polymers Ltd from the end of July 2018. After a downtrend, a Falling Wedge Pattern started forming from December 2018.

Moving between the upper falling resistance line and the lower falling support line for about 18 months, on 8th June 2020 stock gave a breakout from the falling wedge pattern forming a bullish candle. This breakout was on huge volumes indicating that bullish reversal was on cards.

Now, a long entry is taken above 50 (high of the breakout candle) and the stop loss is placed below 34 (minor swing low before breakout).



In case of this pattern, there is no measuring technique to estimate the price target and hence it is advised to use a trailing stop loss or use keep watch on price action to decide the exit.

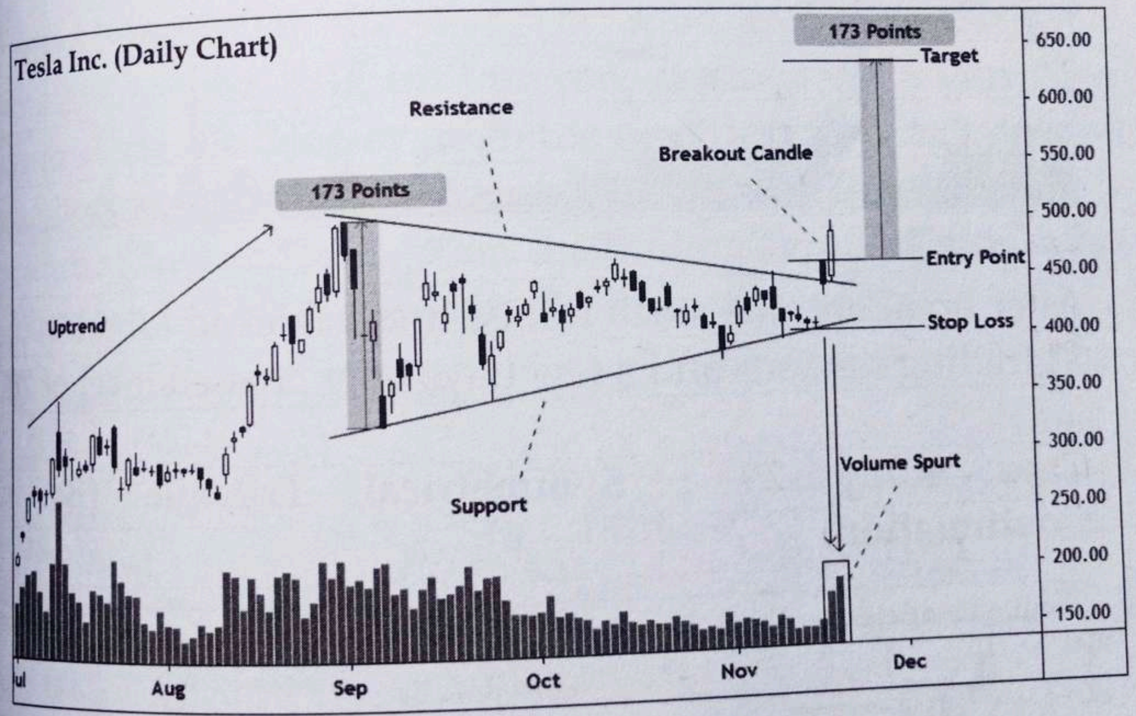


As seen in the chart above, after entering the trade there was a small correction but soon after the stock saw a good up move and within four months stock hit high of 99.90 in the first week of October forming a long bullish candle.

However, the trailing stop loss would have triggered next week when a long bearish candle was formed and stock corrected by around 20% from highs. A trader still got to grab a good part of the up move from 50 till 82 – 83 levels.

Case Study 28 : Symmetrical Triangle (Bullish Continuation)

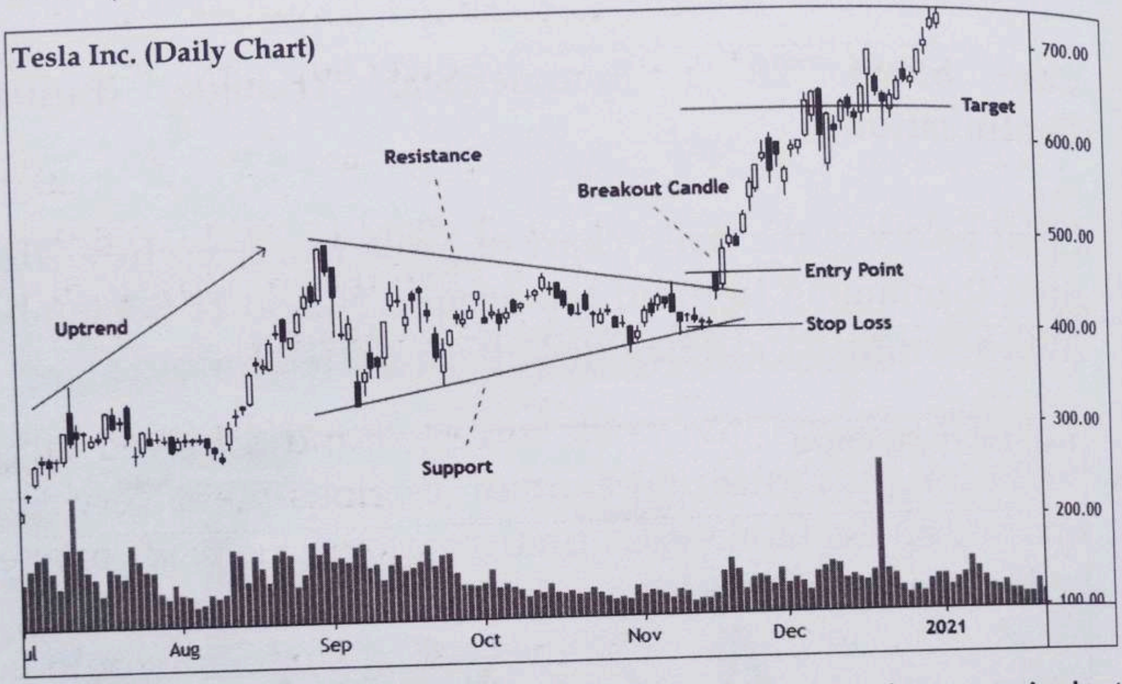
Chart below is the daily chart of Tesla Inc. from July 2020. After forming an uptrend top around 502 on 1st September 2020, a Symmetrical Triangle Pattern started forming.



The trading range started getting narrow and finally on 17th November 2020 price broke the upper resistance with good volumes but failed to close above the upper resistance. Since the price closed just slightly below the upper resistance we need to wait.

The next day the stock opened above the previous day's close and started rising. Now entry can be taken when the price goes above the previous day's high.

Now, a long entry is taken above 462 (high of breakout candle) with a target of around 635 (173 points above the entry point after breakout) and the stop loss is placed below 401.5 (minor swing low before breakout).



After breakout, the stock rallied and achieved target in just 12 trading sessions and a few days later crossed level of 700.

Case Study 29 : Symmetrical Triangle (Bearish Continuation)

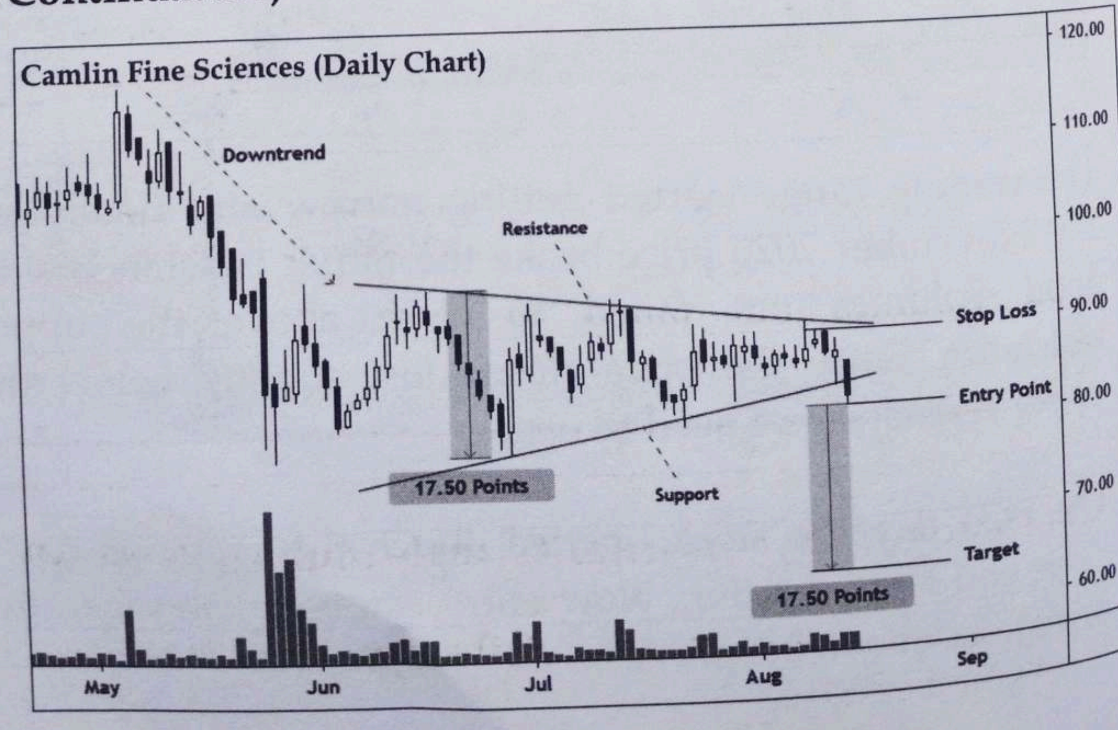
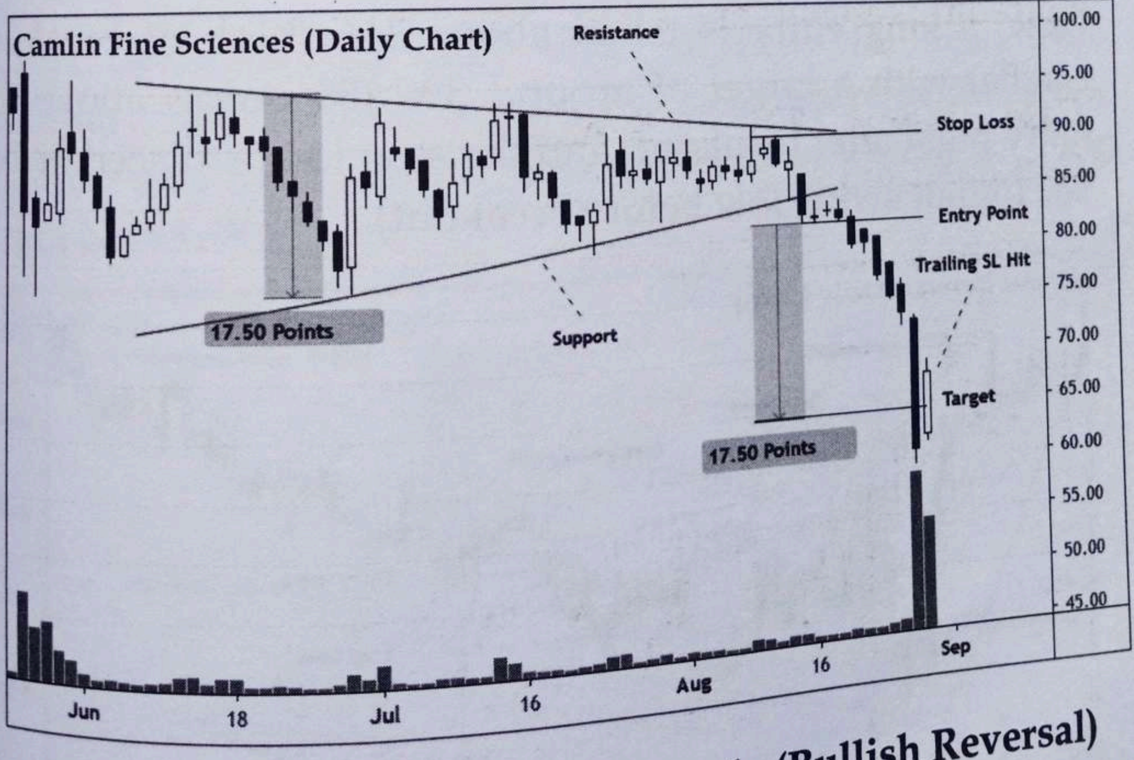


Chart on the previous page is the daily chart of Camlin Fine Sciences from April 2018. A Symmetrical Triangle Pattern started forming on the chart from June 2018.

The trading range started getting narrow and finally on 14th August 2018 price broke the lower support.

Now, a short entry is taken below 82 (low of breakout candle) with a target of around 64.50 (17.50 points below the entry point after breakdown) and the stop loss is placed above 90 (minor swing low before breakout).

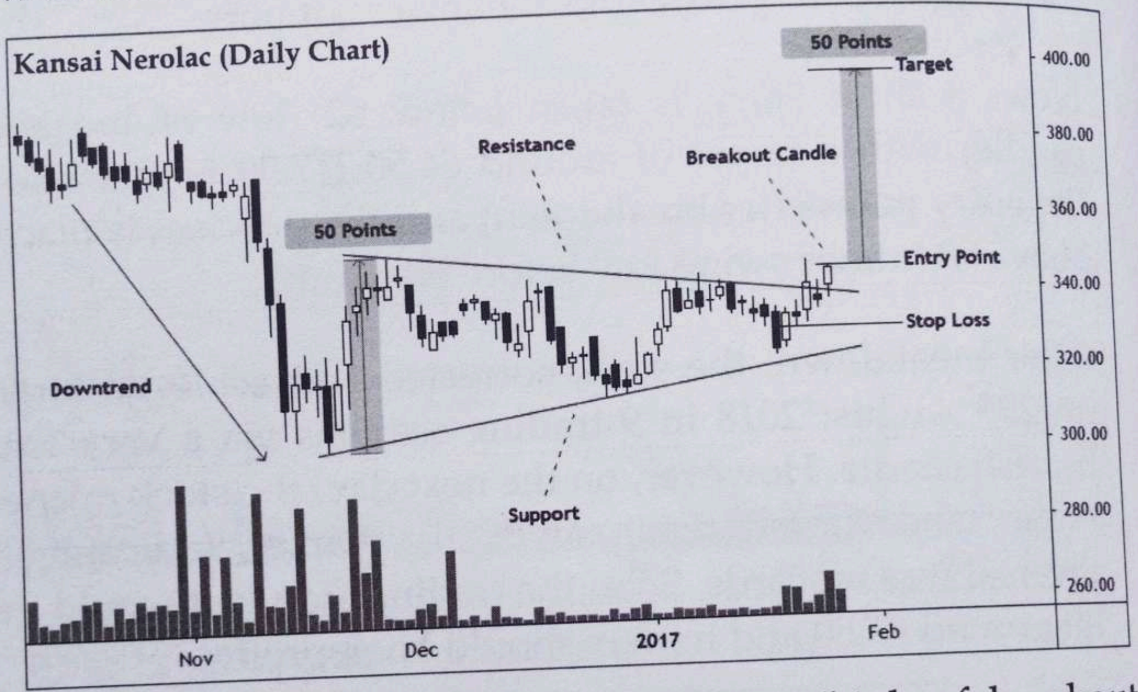
After breakdown, the stock corrected and achieved target on 29th August 2018 in 9 trading sessions via a very long bearish candle. However, on the next day, the stock opened higher and started rising on high volumes, indicating a reversal was on cards. Soon the trailing stop loss would get hit around 67.50 and traders should book profits.



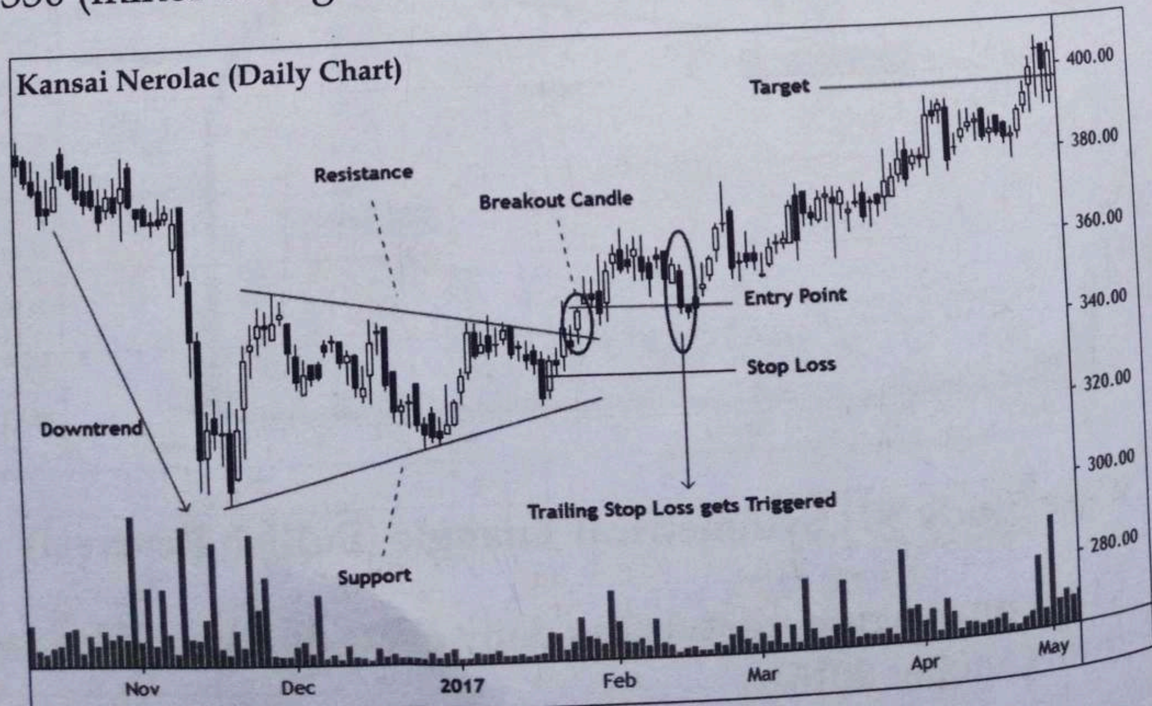
Case Study 30 : Symmetrical Triangle (Bullish Reversal)

Chart on the next page is the daily chart of Kansai Nerolac from October 2016.

After forming a downtrend bottom around 302 on 21st November 2016, a Symmetrical Triangle Pattern started forming. The trading range started getting narrow and finally on 25th January 2017 price broke the upper resistance with decent volumes.



Now, a long entry is taken above 346 (high of breakout candle) with a target of around 396 (50 points above the entry point after breakout) and the stop loss is placed below 330 (minor swing low before breakout).



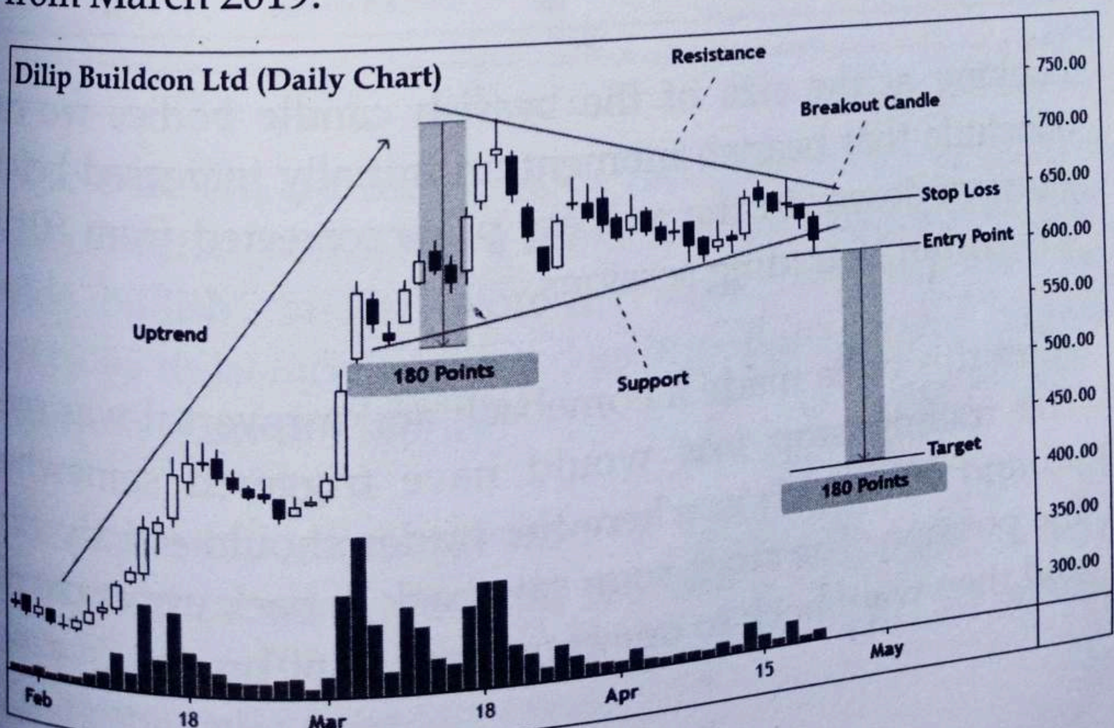
After a decent up move from 346 to 364, the stock started correcting again and came back to the entry level. This is where most probably the trailing stop loss would get triggered for many traders and I would advise traders to strictly exit the position. In this case, the trader might not have lost much as his exit would have been very close to the entry price.

When we look ahead we notice that stock makes a comeback and achieves the target. But one should never regret such things. It is part of the game.

But always stick to your stop loss strategy and never hesitate to close a position when a stop loss or a trailing stop loss gets triggered. This is an important lesson which every new trader must learn as soon as possible.

Case Study 31 : Symmetrical Triangle (Bearish Reversal)

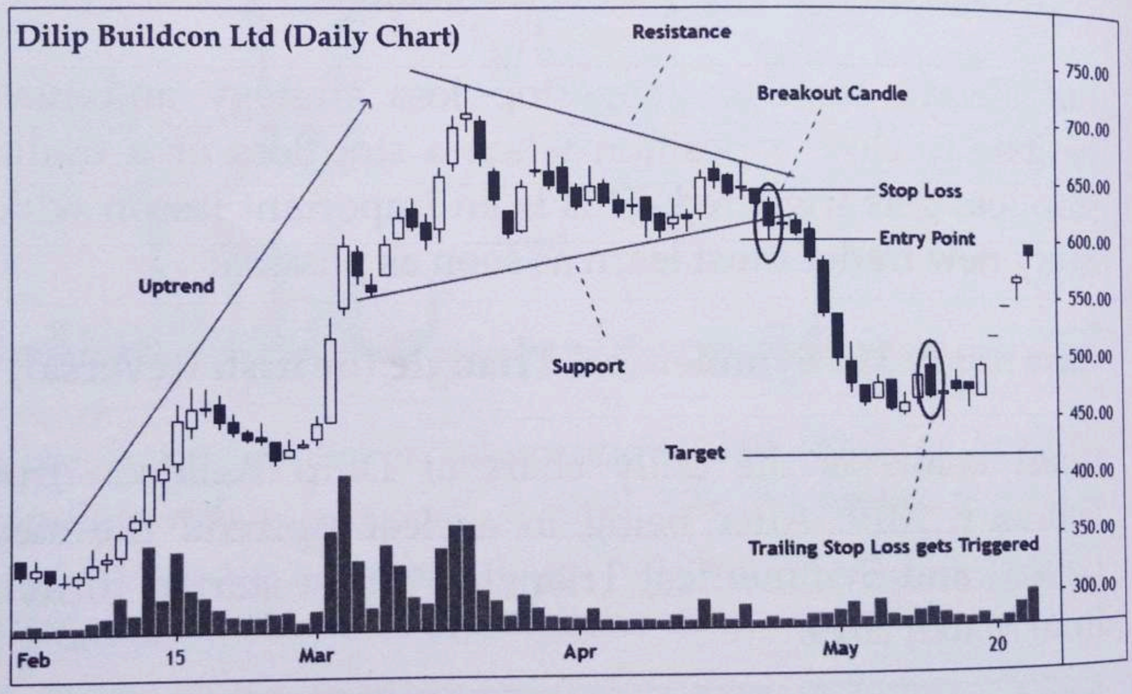
Chart below is the daily chart of Dilip Buildcon from February 2019. After being in a clear uptrend the stock paused and Symmetrical Triangle Pattern started forming from March 2019.



The trading range started getting narrow and finally on 23rd April 2019 price broke the lower support.

Now, a short entry is taken below 601 (low of breakout candle) with a target of around 421 (180 points below the entry point after breakout) and the stop loss is placed above 643 (high of the previous candle).

Now let us see what happened after the breakout in the chart below.



Looking at the size of the bearish candle bodies we can conclude that bearish momentum initially increased before slowing down. In the process price corrected from 601 to 451 within 10 trading sessions.

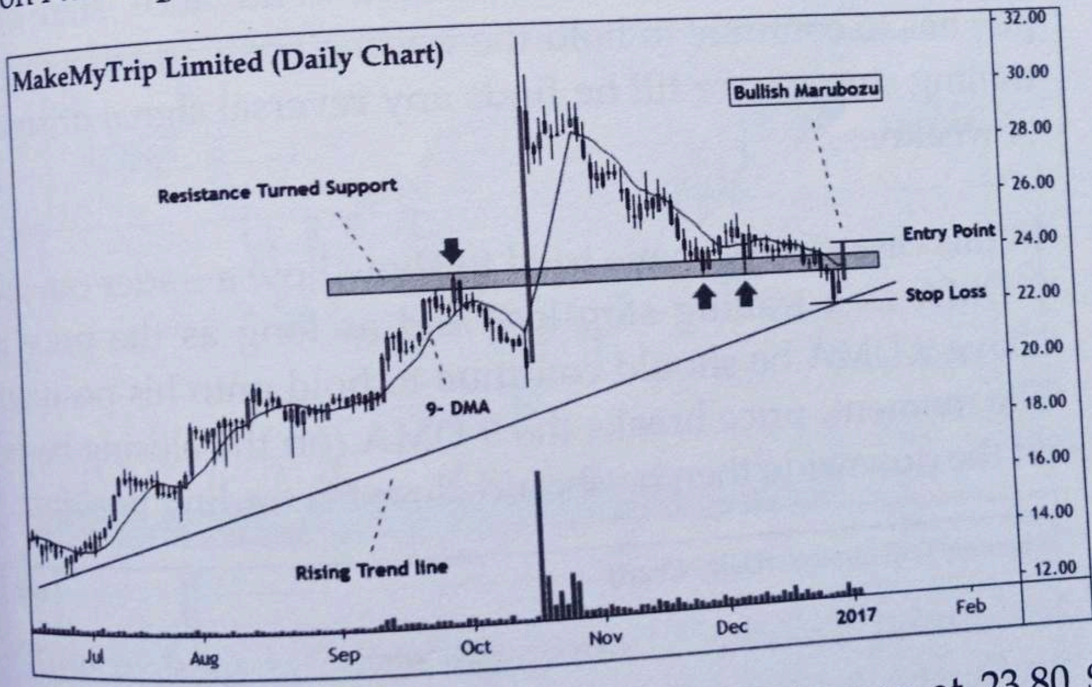
After this bulls made a comeback and a reversal was seen. The trailing stop loss would have triggered somewhere around 493 which is where the trader should strictly close the position. The stock soon saw back to back upper circuits and then went back to our entry level of 601.

In this case study, you can clearly see how the trader was able to lock in the profits of over 100 rupees per share which roughly around 16%.

Hence I always tell one thing – ***'Always stick to your stop loss strategy and never hesitate to close a position when a stop loss or a trailing stop loss gets triggered.'***

Case Study 32 : Bullish Marubozu

Chart below is the daily chart of MakeMyTrip Ltd (Listed on Nasdaq) from June 2016.



After a decent up move, stock faced resistance at 23.80 $ and corrected a bit. Then it broke this resistance with a very wide bullish candle. Soon the stock corrected and the previous resistance now acted as important support on two occasions (Law of Polarity).

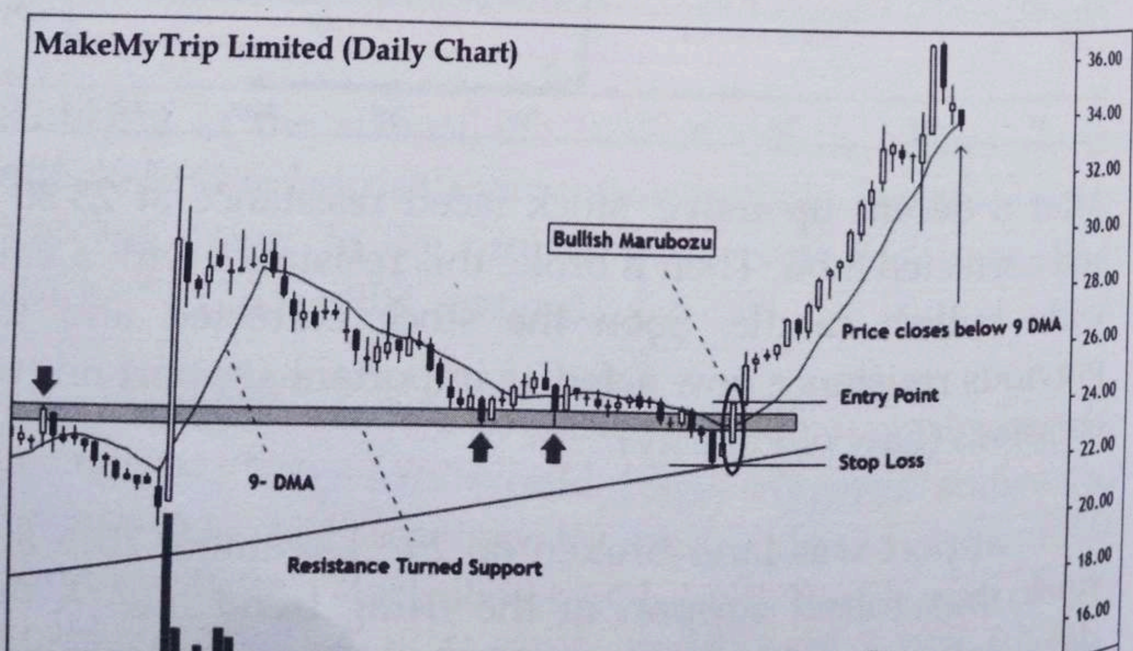
This support was later broken on 29th December 2016 and stock then found support at the rising trend line. A few days later on 4th January 2017, a Bullish Marubozu Candlestick was formed.

Here the Bullish Marubozu was formed in confluence with many bullish triggers like a breakout from 9 DMA, support at rising trend line and area where resistance turned support. All this paved way for a decent up move.

Now, a long entry is taken above 24.20 $ (high of Marubozu candle) and stop loss is placed below 22 $ (minor swing low before Marubozu candle).

In case of trading carried out based on candlestick patterns, a trader should always remember that here there is no specific target that can be calculated in advance. Here one just has to continue to hold the trading position following a trailing stop loss or till he finds any reversal signal or signs of weakness.

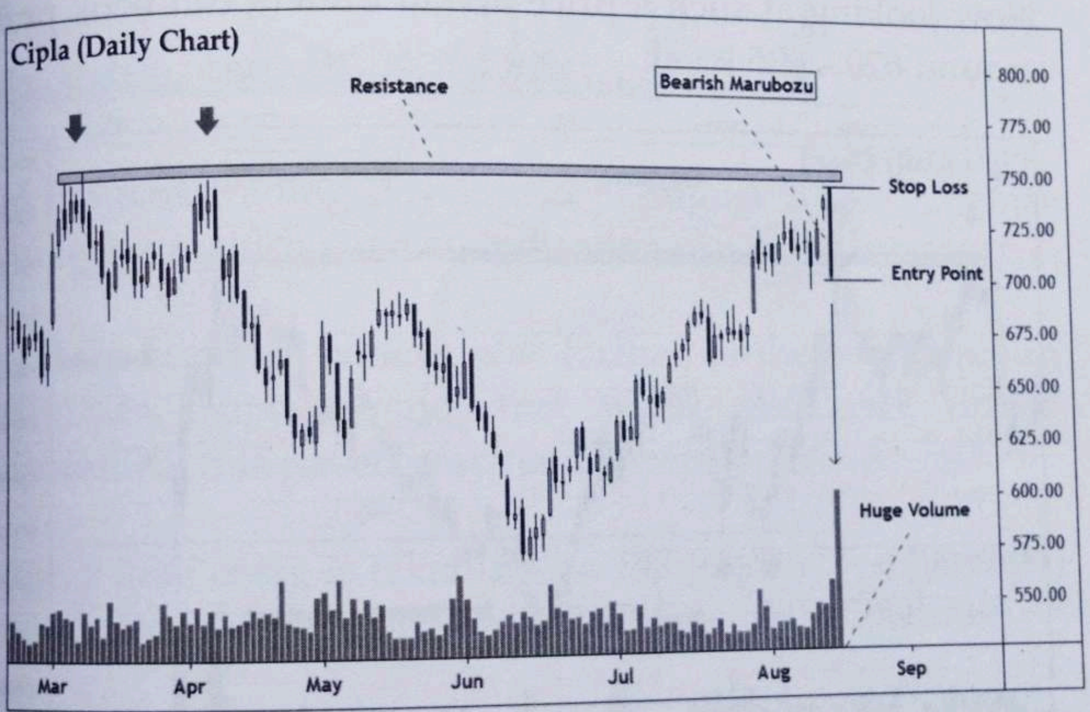
In this case study, I have tried to show how a trader can use 9 DMA as a trailing stop loss and as long as the price is above 9 DMA he should continue to hold onto his position. The moment, price breaks the 9 DMA (on the closing basis) on the downside then he should close his trading position.



On 6th February 2017, the price closed slightly below 9 DMA and hence trader exits the position on the next trading day. A decent profit was made by the trader as the price moved from 24 \$ to 33 \$, a gain of around 38% in a month's time.

Case Study 33 : Bearish Marubozu

Chart below is the daily chart of Cipla from February 2015.



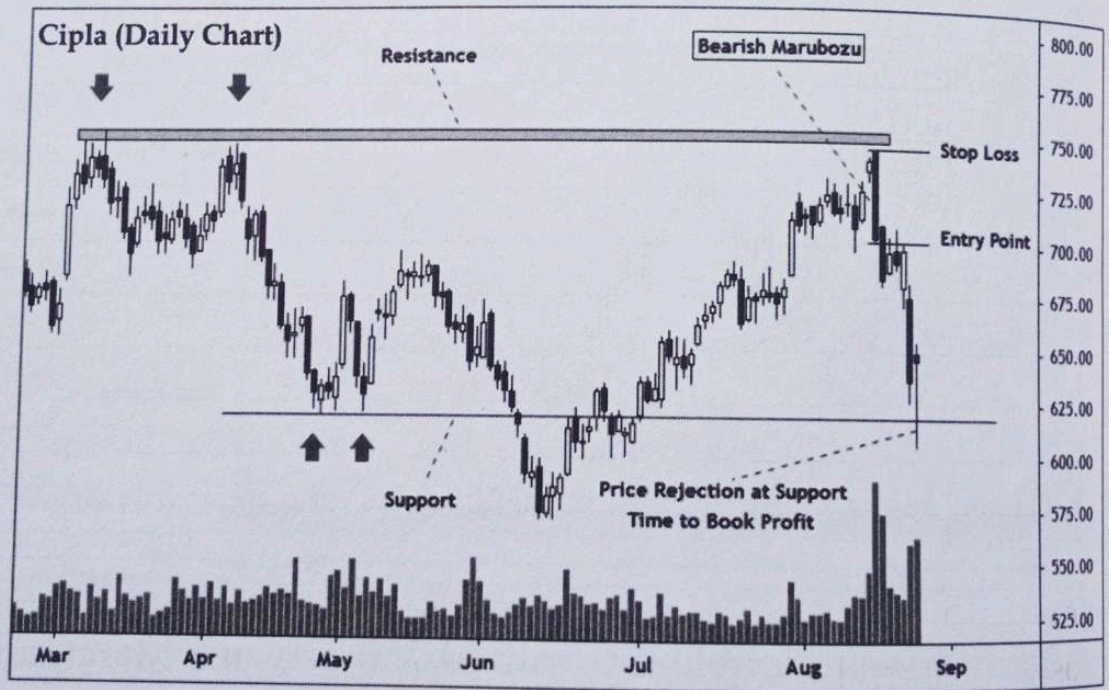
After making a double top around 750 between March and April 2015, the stock corrected to the level of 570 in June 2015. The stock then reversed its direction and went on to test the previous resistance.

A Bearish Marubozu was formed on 17th August 2015 such that the body of the candle was more than three times the size of the previous day's candle. This bearish candle was formed at important resistance and with huge volume. It also formed a bearish engulfing pattern that day. All this indicates a strong bearish reversal is bound to happen.

Now, a short entry is taken below 701 (low of Bearish Marubozu candle) and stop loss is placed above 745 (high of Bearish Marubozu candle).

As you can see in the chart below, in no time the stock price crashes to levels of 625. The next day, i.e., on 25th August 2015 one can notice price rejection from support level around 618.

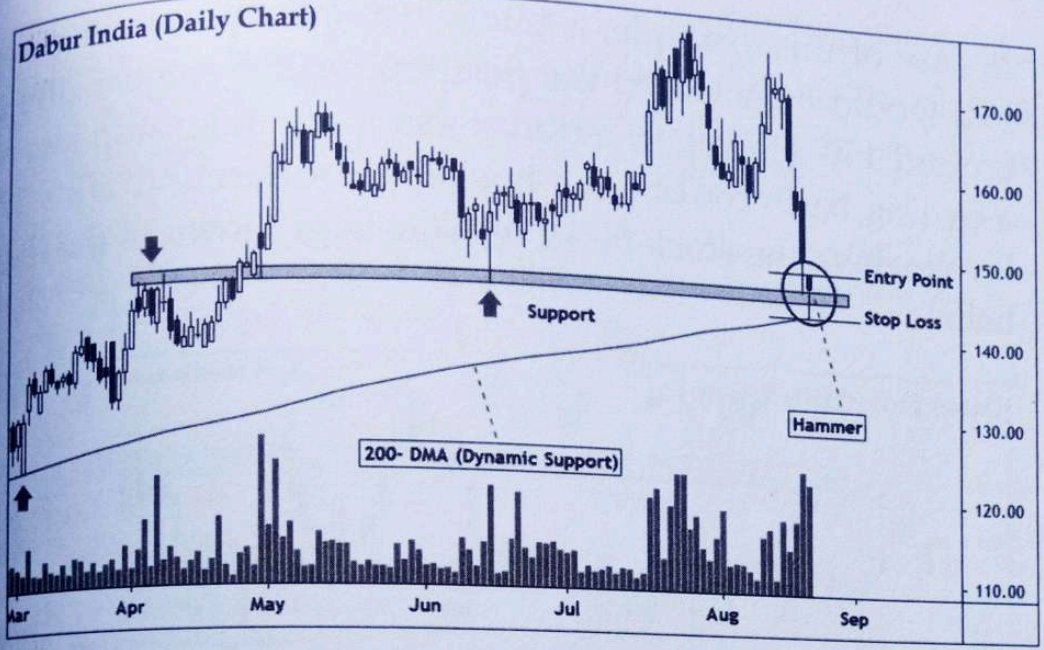
Now looking at such a price action traders can book profit around 620 – 625 level.



Case Study 34 : Hammer

Chart on the next page is the daily chart of Dabur India from March 2013.

After an up move from March 2013, the stock made a short term top on 25th July 2013 at 177.40 and then started correcting. It soon came back to the support zone which had earlier acted as a resistance.



On the next trading day i.e., 22nd August 2013 a hammer was formed which gave an indication of a trend reversal.

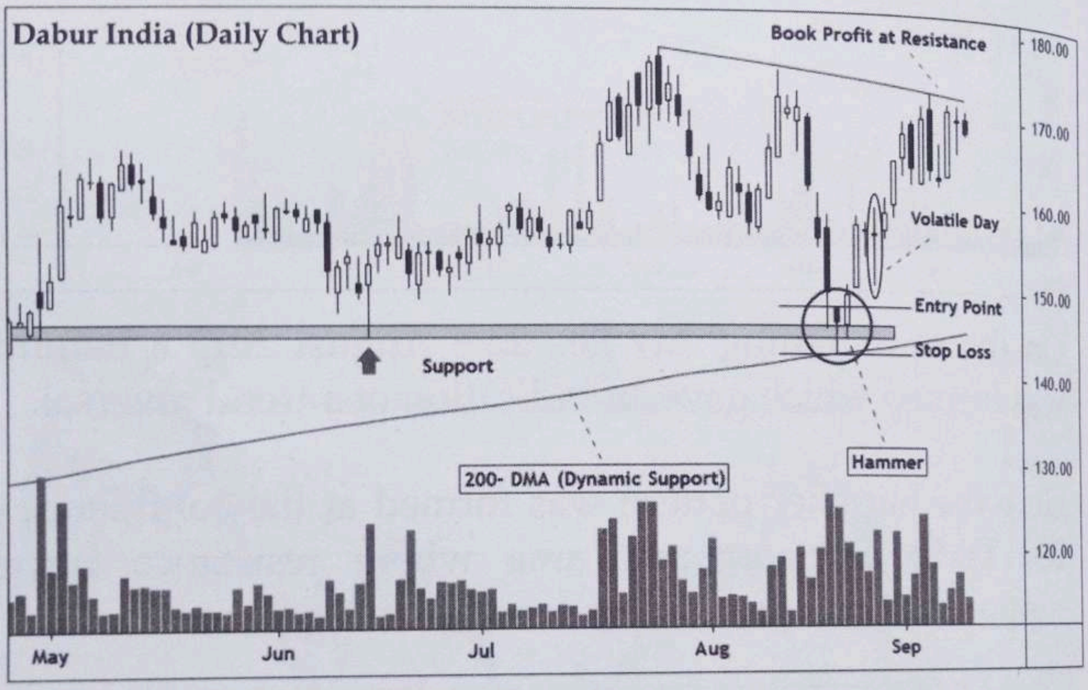
Here the hammer pattern was formed at the confluence of 200 DMA Support and area where resistance turned support. All this paved way for a decent up move.

Now, a long entry is taken above 148 (high of the hammer) and stop loss is placed below 142.70 (low of the hammer).

Now stop loss in this case is around 6 rupees but if you closely watch the earlier candles then you will realize that the daily trading range of the stock is around 8 – 12 rupees. Hence in such cases either we can use a wider stop loss or in case of positional trades, we can apply stop loss on a closing basis.

In case when stop loss applied on closing basis, the closing price is considered important to come to a conclusion however in intraday the price could go below the stop loss level but it is the closing price at the end which matters and the stop loss are intact if the closing price is above that.

In case of this example, a trader using simple trailing stop loss would have exited the position on 28th August 2013 at around 152. However, a trader using a trailing stop loss on a closing basis could have booked profit around 172 - 173 level, where the stock faced resistance as shown in the chart below.

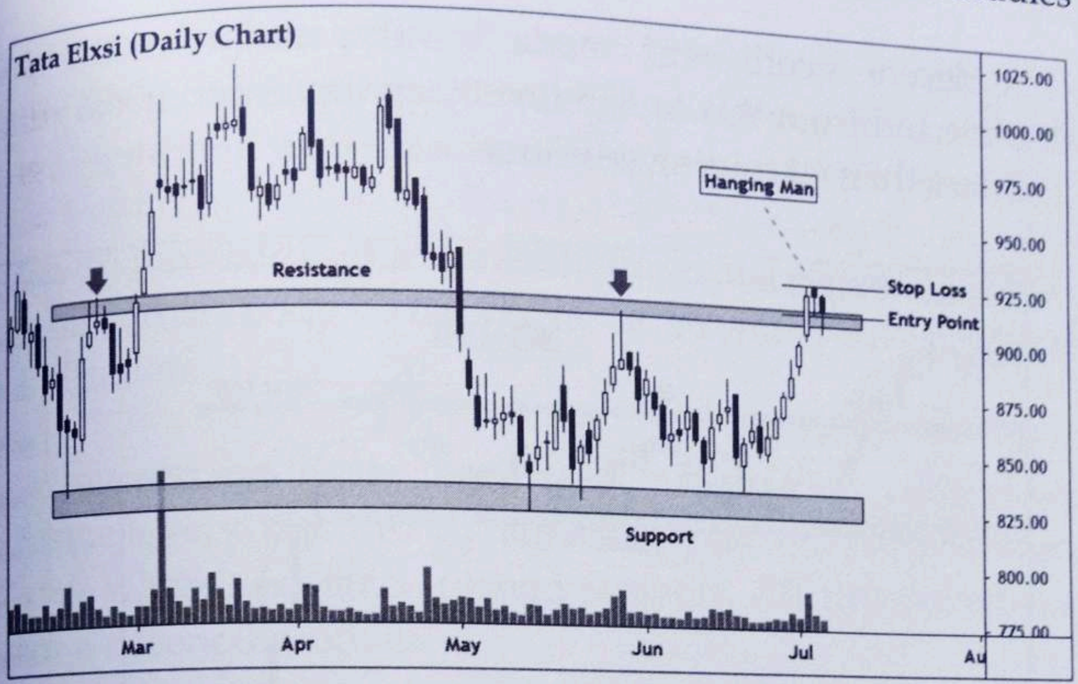


Now here, one thing I would like to tell you that before initiating a trade you need to decide which stop loss strategy you are going to follow. ***Never change a stop loss strategy after initiating a trade.***

Case Study 35 : Hanging Man

Chart on the next page is the daily chart of Tata Elxsi from February 2019.

After facing stiff resistance at level of 1000 between March 2019 and April 2019 the stock corrected sharply to levels of 830. The stock then gave a pullback till 909 where it faced resistance and again came back to support around 830 level.



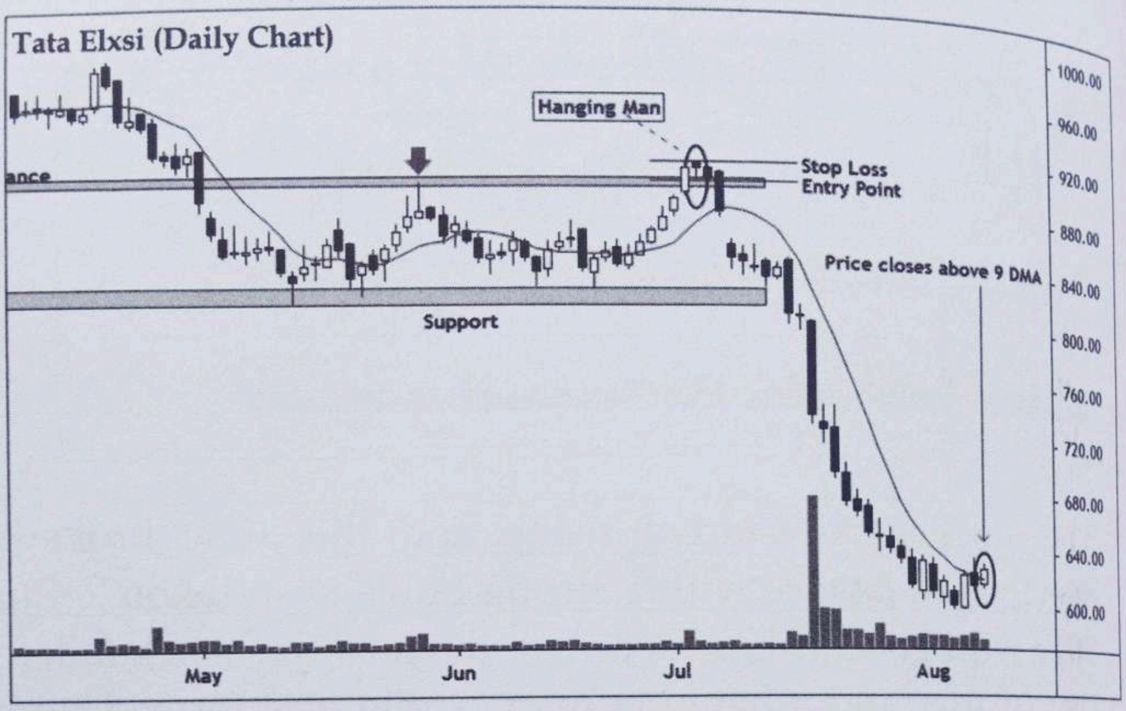
The stock again started rising and this time broke the previous resistance with a strong bullish candle on 2nd July 2019 with good volumes. But on the next day stock failed to rise further and a hanging man candle was formed with a black body, giving a stronger bearish signal.

The next day again price starts falling and hence a short entry is taken below 192 (low of the hanging man) and stop loss is placed above 925 (above high of the hanging man).

In this case, a trader can use the 9 DMA as a trailing stop loss indicator and as long as the price is below 9 DMA he should continue to hold onto his short position. The moment the security price crosses the 9 DMA (on the closing basis) on the upside then he should close his trading position.

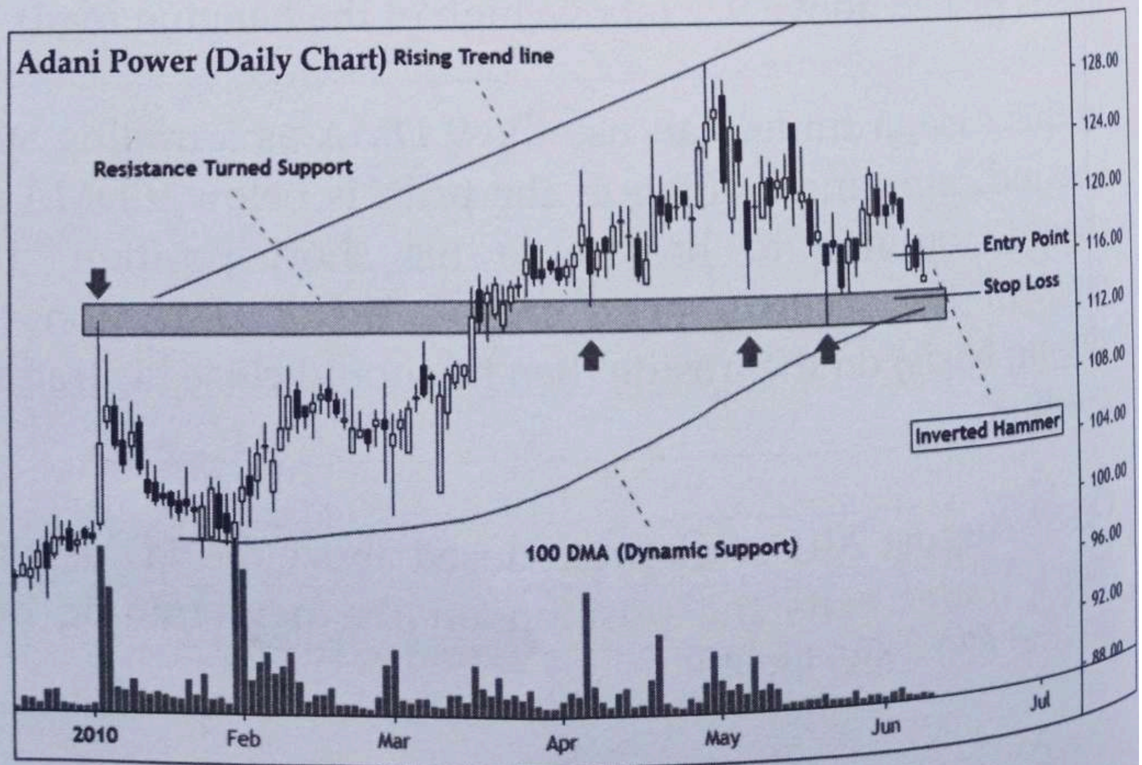
On 8th August 2019 stock price closed above the 9 DMA and hence trader exits the position on the next trading day around 630 – 635 level.

A decent profit was made by the trader as the price corrected from 904 to 635 levels, giving around 30% return in less than 40 trading sessions.



Case Study 36 : Inverted Hammer

Chart below is the daily chart of Adani Power from December 2009.



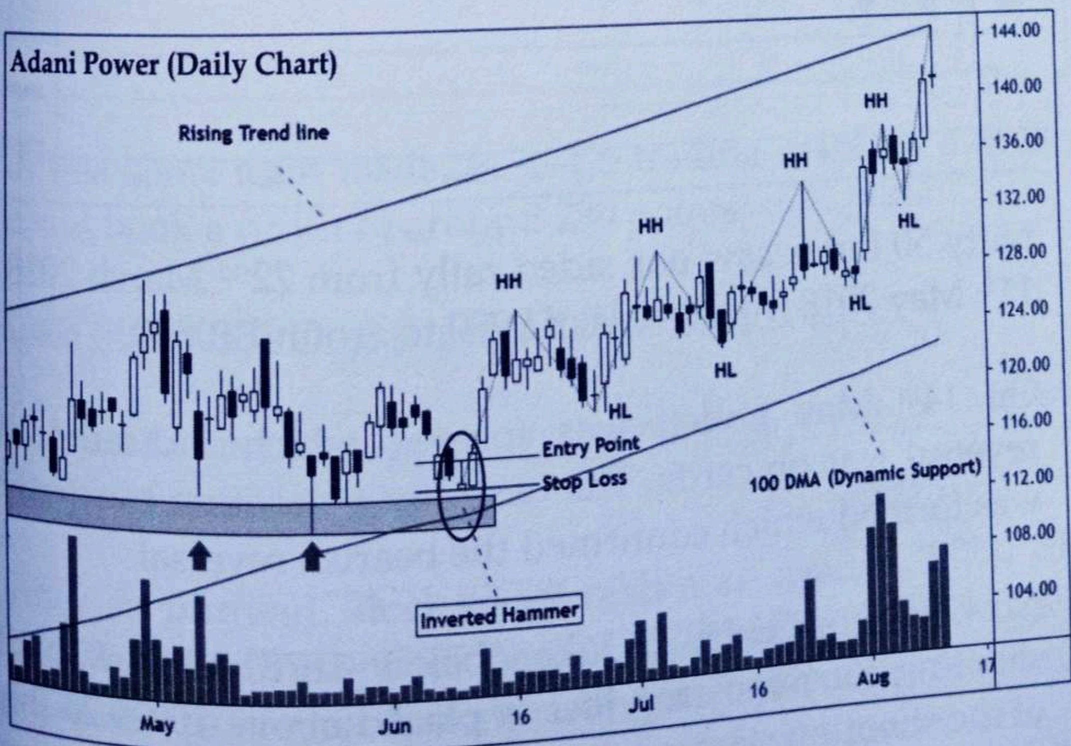
After making an uptrend top at 128.90 on 30th April 2020 the stock corrected to 115 levels and during this correction, it twice found support around this level.

On 9th June 2020, an inverted hammer was formed having a white real body. This gave a strong bullish reversal indication.

As we can see in the above chart, an inverted hammer was formed very close to dynamic support on 100 DMA and area where resistance turned support. All this paved way for a decent up move.

The next day price starts rising and hence a long entry is taken above 116.50 (high of the inverted hammer) and stop loss is placed below 114.50 (low of the inverted hammer).

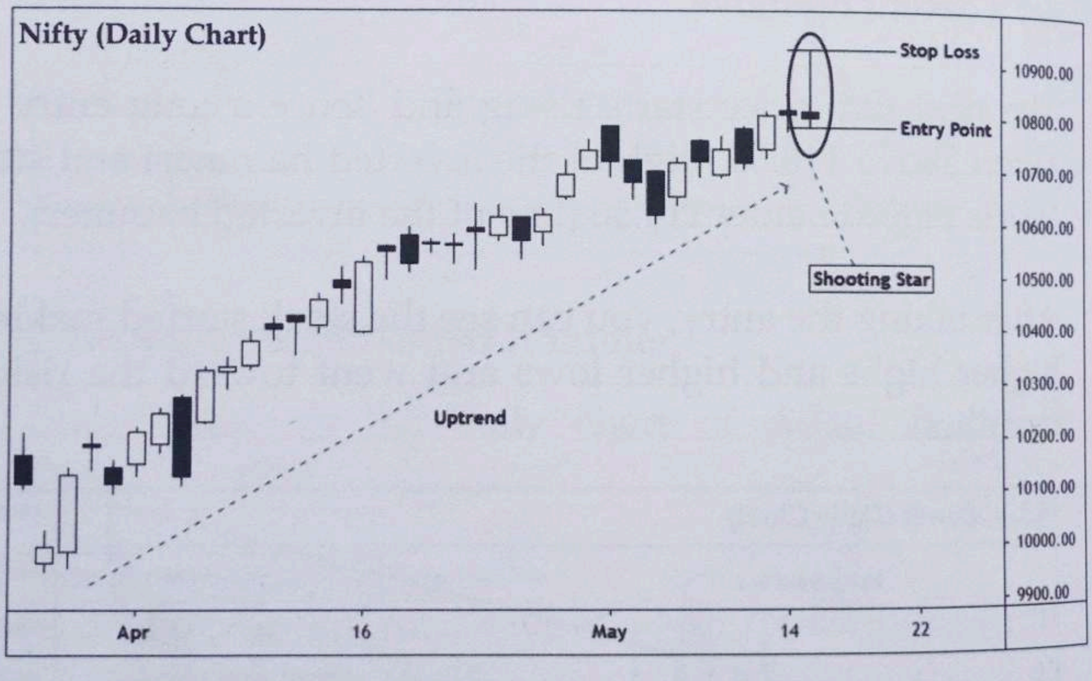
After taking the entry, you can see the stock started making higher highs and higher lows and went toward the rising trendline.



In this case, the trader could trail the stop loss from one higher low to another higher low and eventually book the profit when the stock faced resistance at the rising trend line at around 144. At that level you will notice a doji candlestick which is a sign of indecision which acts as a warning sign of reversal.

Case Study 37 : Shooting Star

Chart below is the daily chart of Nifty 50 Index from March 2018.



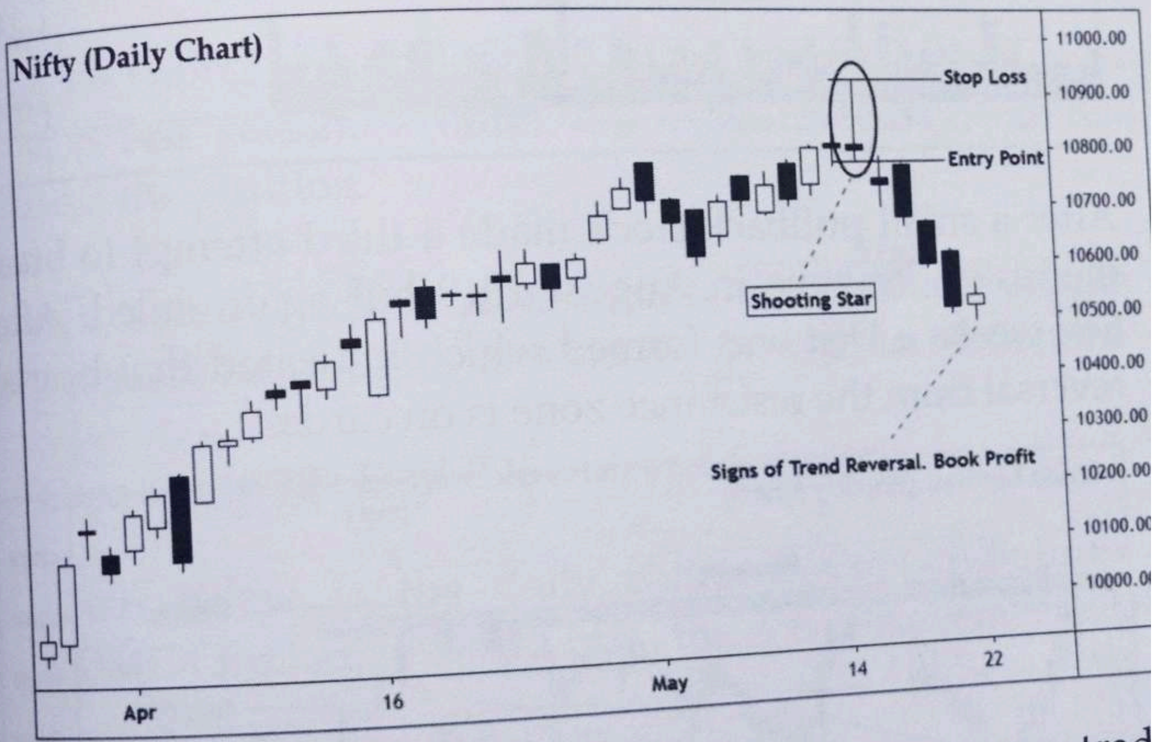
Nifty 50 Index saw one sided rally from 22nd March 2018 to 11th May 2018 from levels of 9950 to around 10800.

On 14th May a doji was formed which indicated that reversal was on cards. The next day a shooting star pattern was formed which confirmed the bearish reversal.

Now, a short entry is taken below 10781.40 (low of the shooting star) and stop loss is placed above 10929.20 (high of the shooting star).

Now in the chart below you can see that after the formation of the shooting star pattern, Nifty started correcting and within four trading session's Nifty hit a low of 10505.80.

The next day i.e., on 22nd May 2018 a bullish candle was formed such that it resulted in Bullish Harami Pattern indicating a bullish reversal on cards and looking at such price action, traders can book profit in closing minutes of the day around 10550.

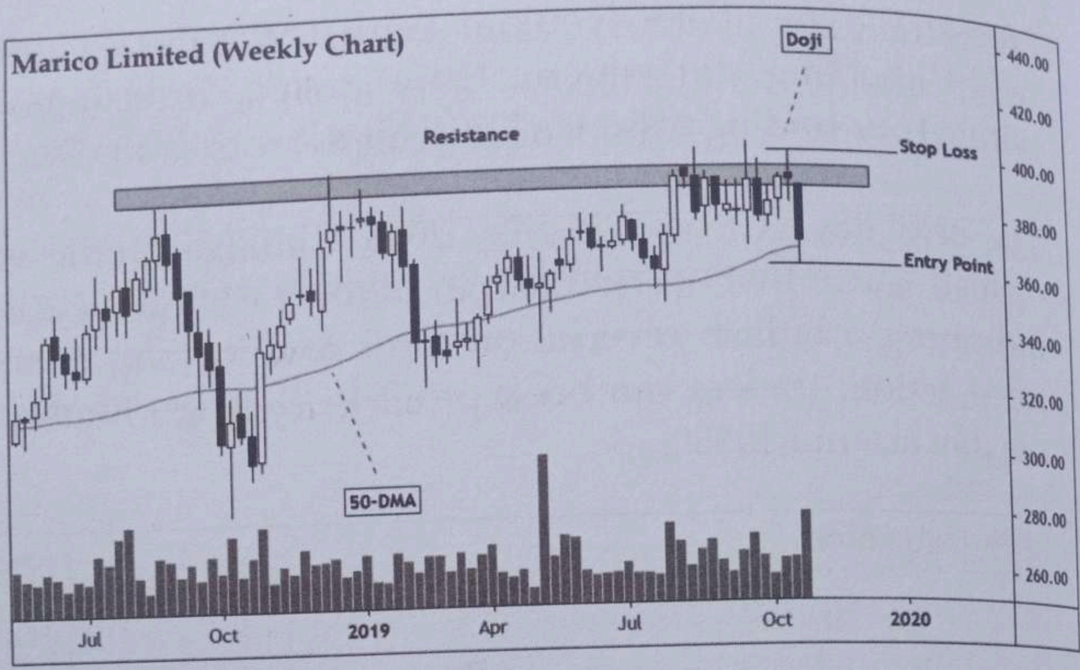


In this short term trade, in just 5 trading sessions, a trad could book a profit of around 230 points.

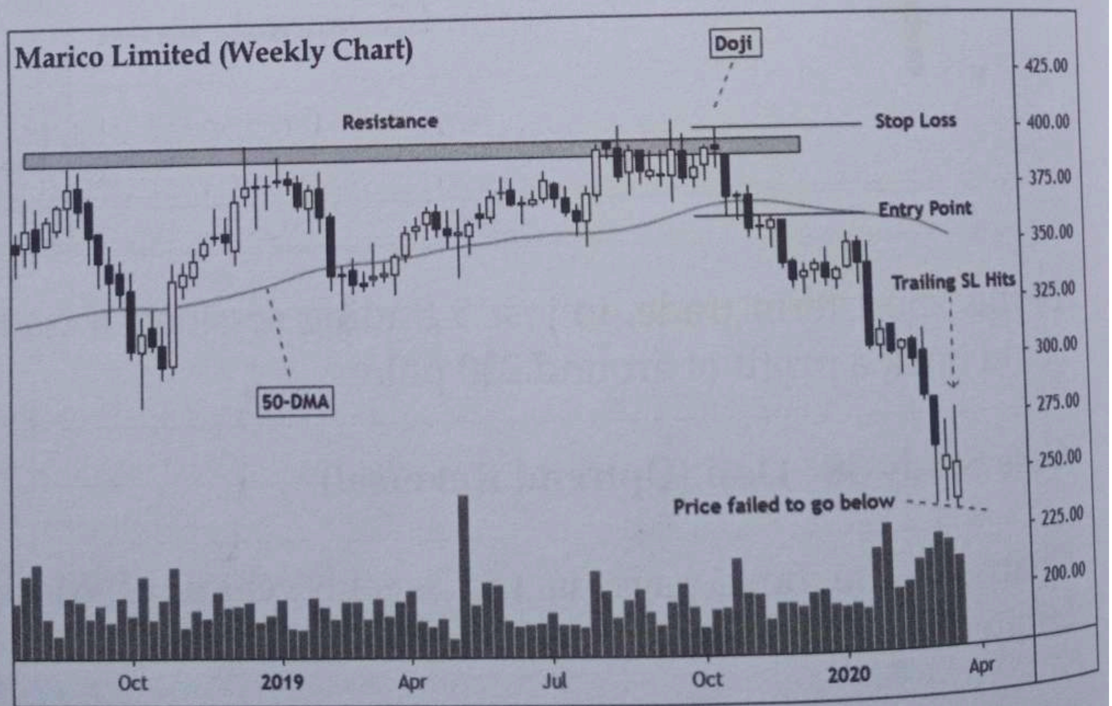
Case Study 38 : Doji (Uptrend Reversal)

Chart on the next page is the weekly chart of Mar Limited from May 2018.

After an uptrend, stock faced resistance around 387 – level towards the end of August 2018 and corrected d to 300 levels in next 2 months. The stock bounced back again faced resistance in the same zone in December 201



After a small pullback stock made a third attempt to break the resistance zone in August 2019 but again failed. After few weeks a Doji was formed which indicated that bearish reversal from the resistance zone is on cards.



The next candle was a bearish candle which confirmed that reversal was on cards and the price was very close to 50 DMA breakdown.

Now, a short entry is taken below 362.25 (low of the confirmation candle formed after doji) and stop loss is placed above 400.90 (high of doji candle).

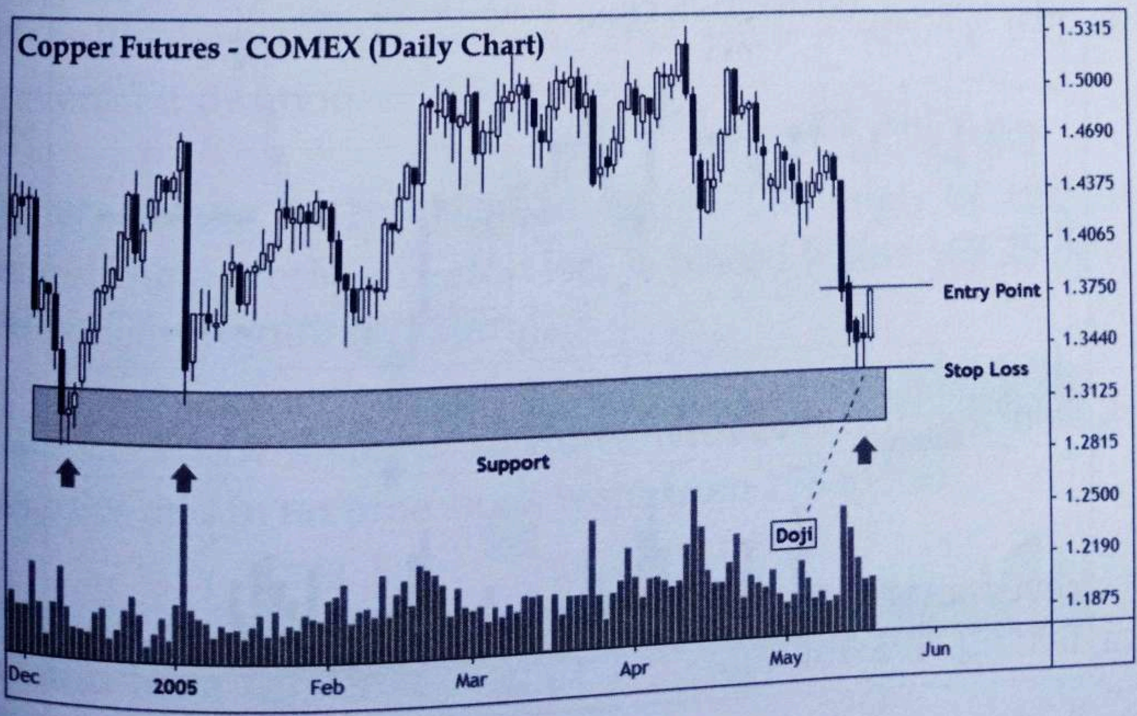
Now in the chart below you can see that after failing to go below the entry level for a few weeks stock finally started correcting and in few months hit a new low of 236.05 in March 2019 but then bounced back from there. Traders need to be cautious now.

After failing to go below 235 in the next few weeks, trailing stop loss gets hit around 272 - 273 levels and the trader exits the position.

In this short trade, a trader could make a profit of around 90 per share i.e., roughly around 25% in less than 4 months.

Case Study 39 : Doji (Downtrend Reversal)

Chart below is the daily chart of Copper Futures on COMEX Exchange (USA) from the end of November 2004.

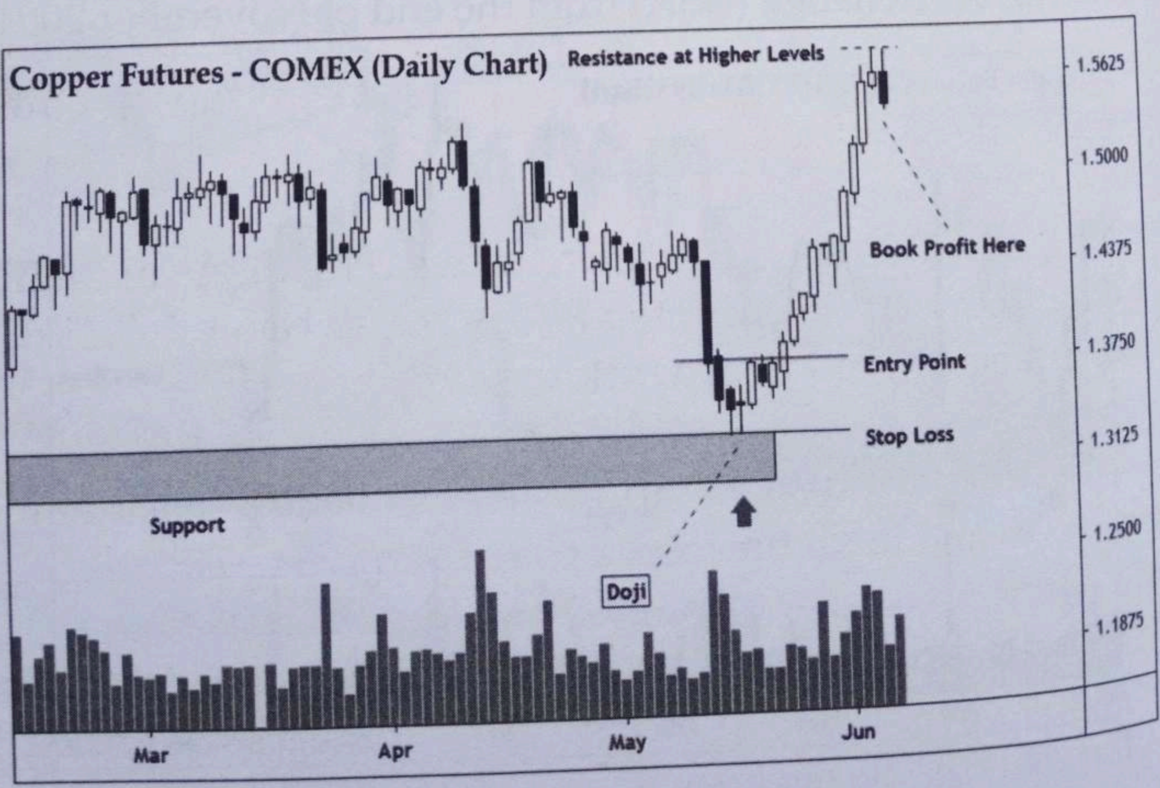


After making a top around 1.5 $ and facing resistance at that level copper prices corrected and reached the support zone of 1.3 – 1.3305 $. A doji was formed on 17th May 2005 with lower volumes as compared to the volume of previous few days when the price was falling.

This doji indicated that bullish reversal from the support zone is on cards. The next candle was a bullish candle which confirmed that reversal was on cards.

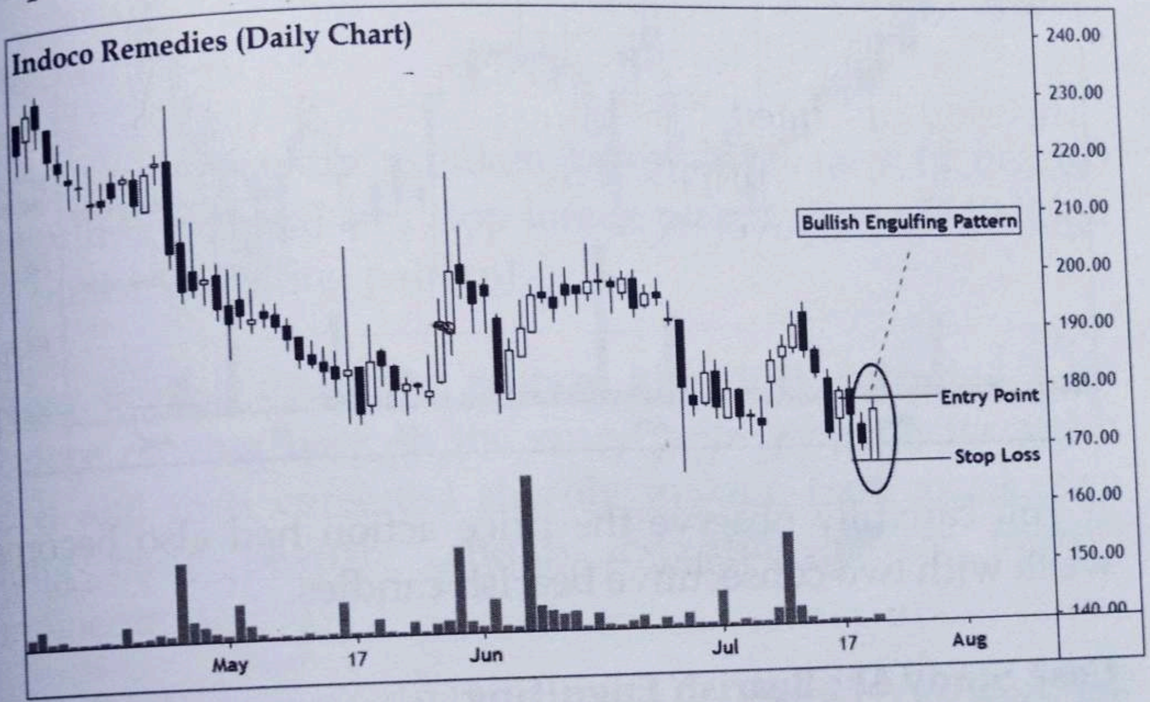
Now, a long entry is taken above 1.378 $ (high of the confirmation candle formed after doji) and stop loss is placed below 1.3310 (low of doji candle).

Now in the chart below you can see that after taking an entry the price went down a bit and then saw a one-sided rally which gained momentum and the price of copper soon reached 1.58 $ where it faced resistance. On 7th June 2005, a bearish candle was formed and this is when a trader can book profit looking at the price action.



Case Study 40 : Bullish Engulfing

Chart below is the daily chart of Indoco Remedies from April 2018.

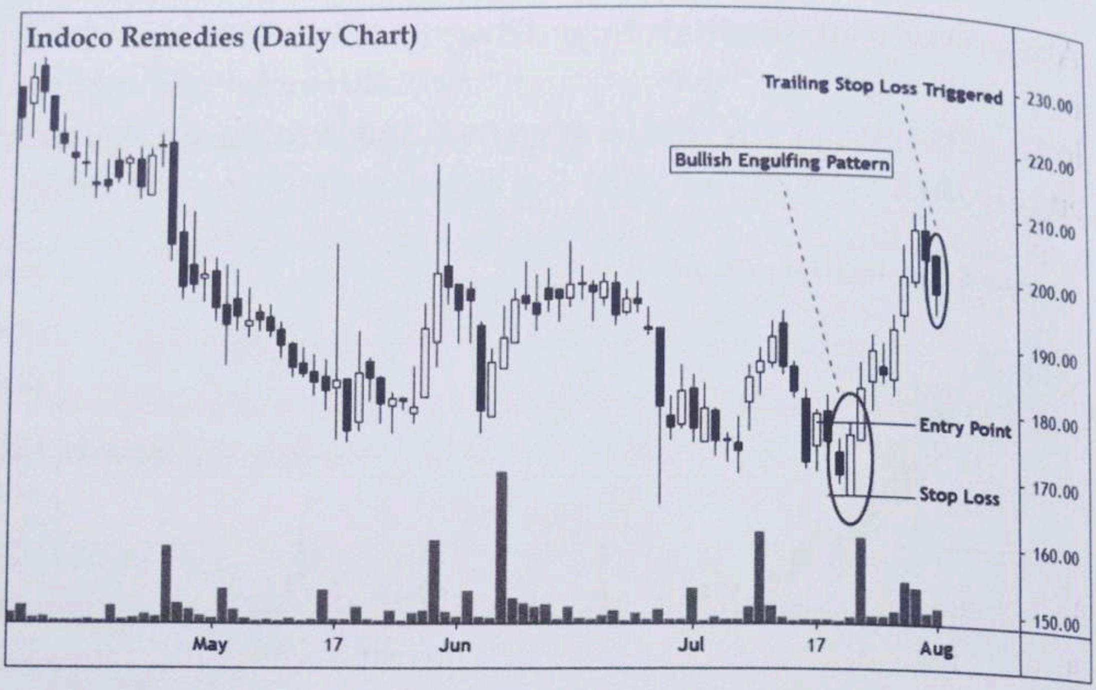


After a sustained downtrend of few months on 19th July 2018, a small body bearish candle was formed. The next day a long body bullish candle was formed which completely engulfed the previous day's bearish candle thereby forming a bullish engulfing pattern. This gave a strong bullish reversal indication.

Now, a long entry is taken above 178 (high of bullish engulfing pattern) and stop loss is placed below 167.25 (low of bullish engulfing pattern).

The stock saw a sharp up move with back to back bullish candles and in no time stock went from 178 to 210.

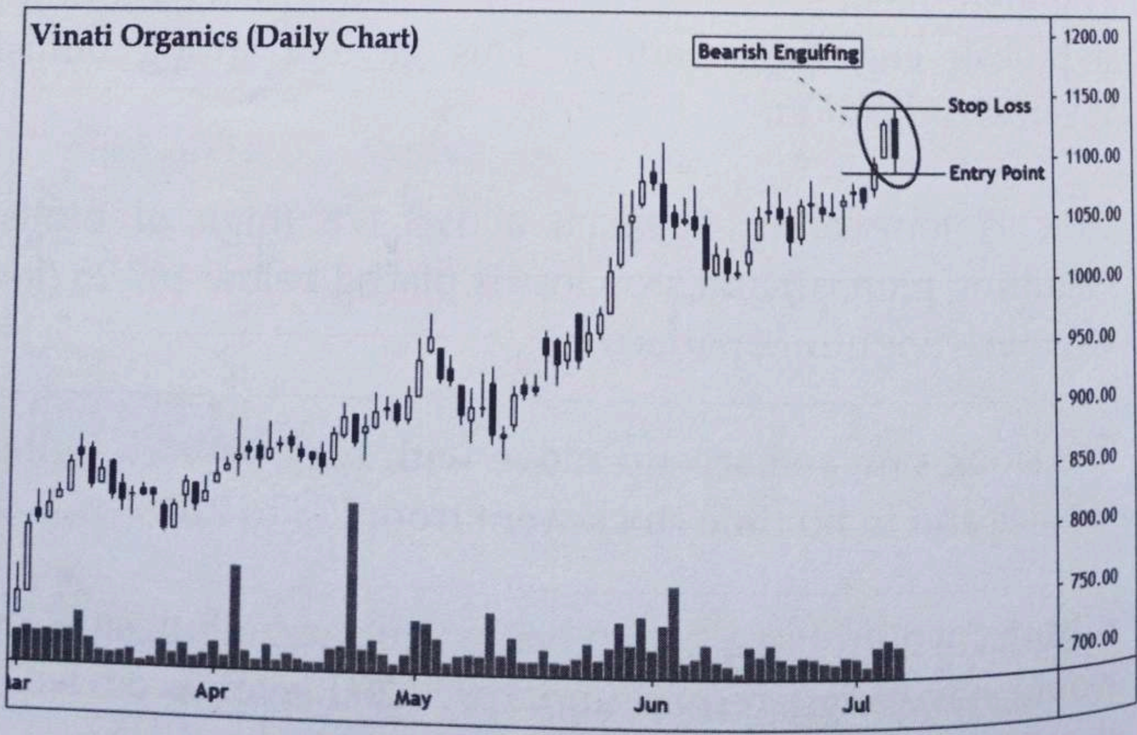
A trader would have got an exit when the trailing stop loss would have triggered around 199 – 200 level as circled in the chart on the next page.



If you carefully observe the price action had also become weak with two consecutive bearish candles.

Case Study 41 : Bearish Engulfing

Chart below is the daily chart of Vinati Organics from March 2019.

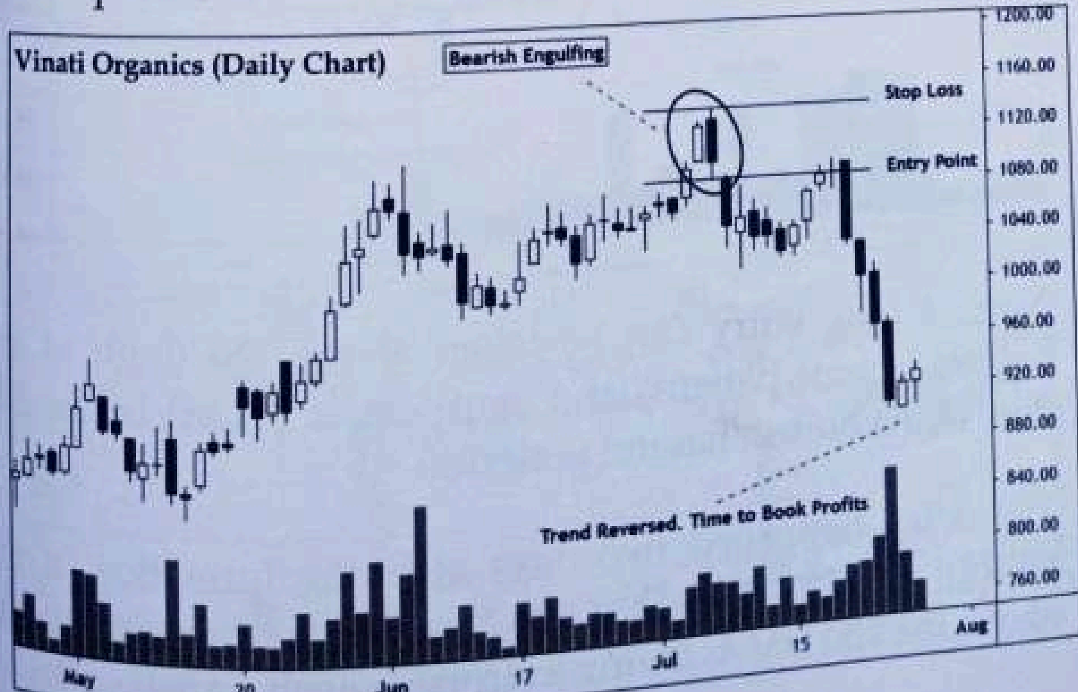


After a continued uptrend for a few months, a small body bullish candle was formed on 4th July 2019. The next day a long body bearish candle was formed which completely engulfed the previous day's bullish candle thereby forming a bearish engulfing pattern. This gave a strong bearish reversal indication.

Now, a short entry is taken below 1086 (low of bearish engulfing pattern) and stop loss is placed above 1140 (high of bullish engulfing pattern).

After bearish engulfing pattern, the stock corrected a bit before moving back to the entry point where it formed a doji and then corrected sharply making four consecutive long body bearish candles indicating strong bearish momentum.

On 24th July 2019 stock made a low of 905.50. The next day stock failed to go down further and a bullish candle was formed with decent volumes. This gave an indication that the stock may bounce back from here and hence traders can book profits at these levels.

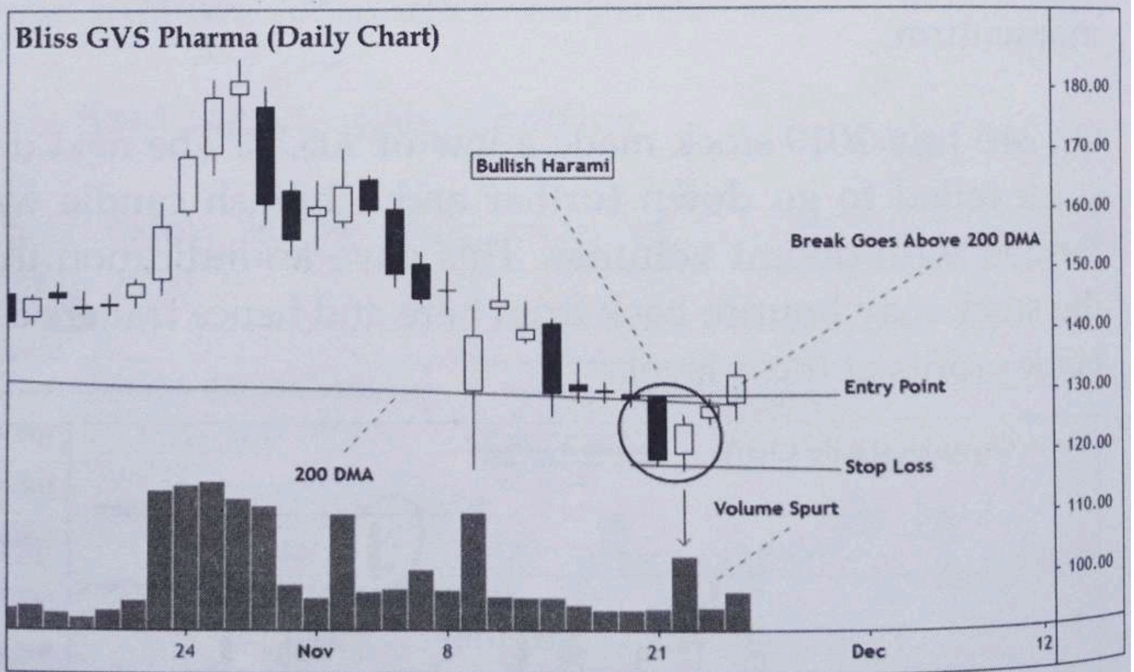


Case Study 42 : Bullish Harami

Chart below is the daily chart of Bliss GVS Pharma from October 2016.

After a downtrend of two weeks, three consecutive doji were formed. This was followed by a long body bearish candle on 21st November. The next day i.e., on 22nd November 2016 a small body bullish candle was formed such that it resulted in a Bullish Harami Pattern.

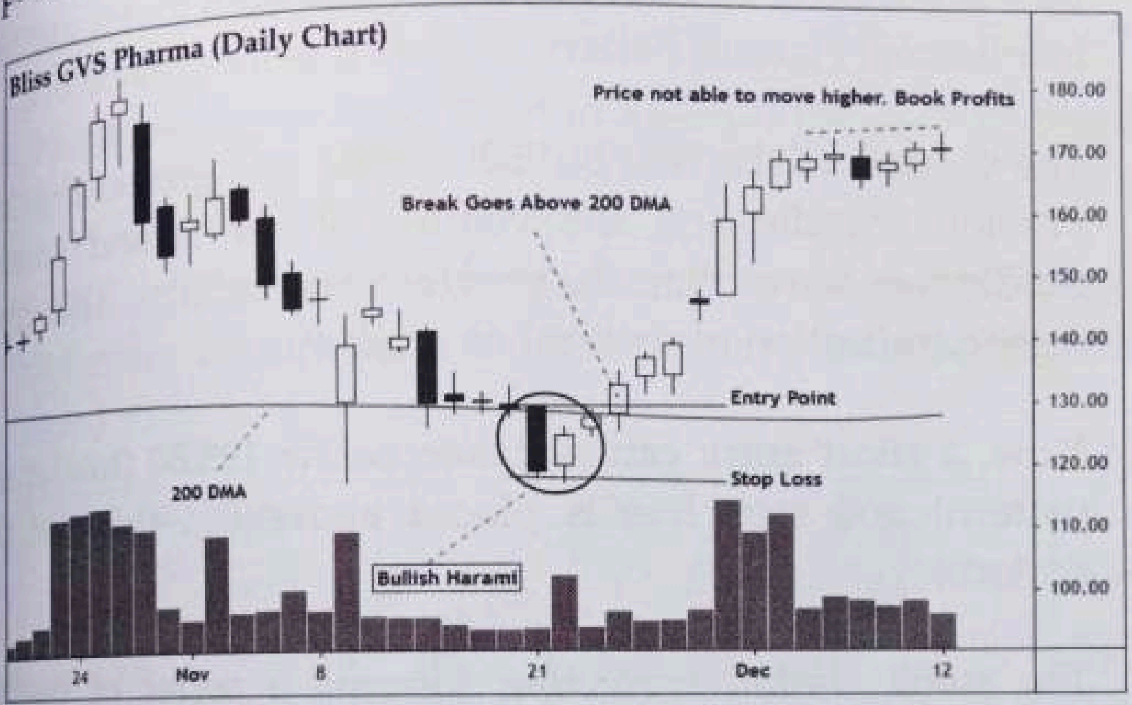
This Bullish Harami Pattern was formed with huge volume as shown in the chart below. This signified that a strong bullish reversal was on cards.



Now, a long entry can be taken above 130 (high of the bullish harami pattern) and stop loss is placed below 117 (low of the bullish harami pattern).

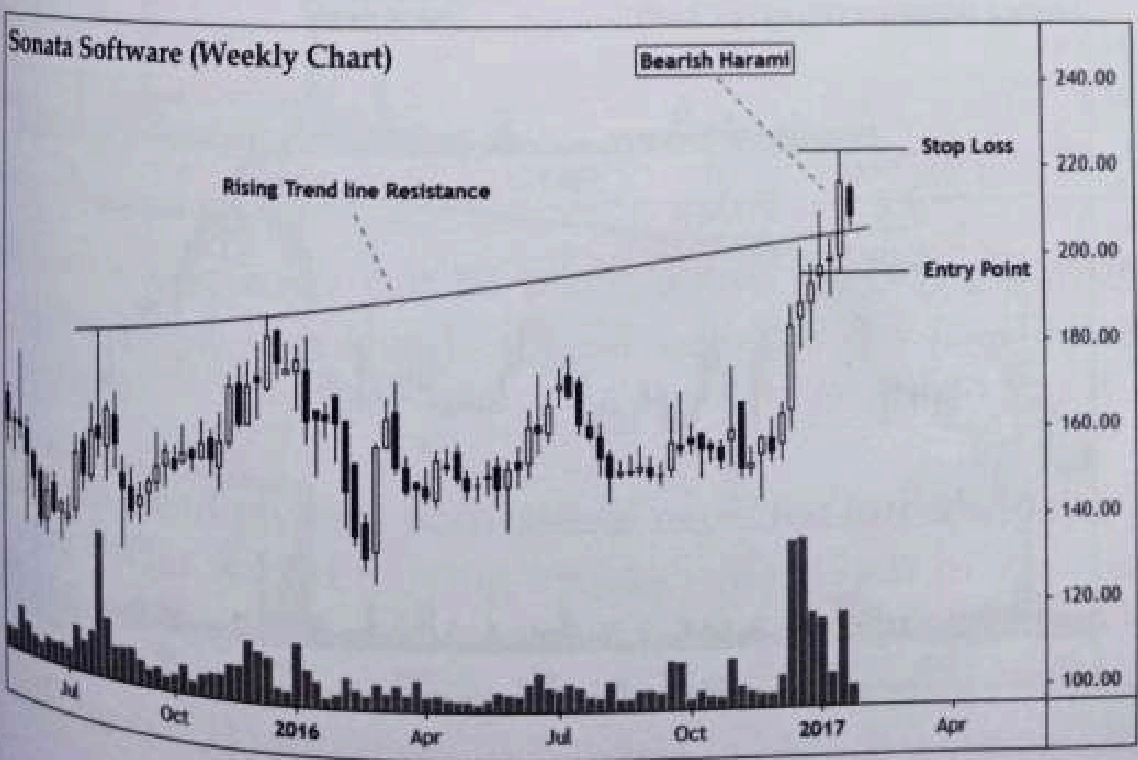
The entry happened two days after the formation of the pattern on 24th November. On this day the price also went above the 200 DMA, giving a strong bullish signal.

In a week, the stock went from 130 to 172 before it started facing resistance. It is the time when traders can book profits as no more bullish momentum was left.



Case Study 43 : Bearish Harami

Chart below is the weekly chart of Sonata Software from May 2015.

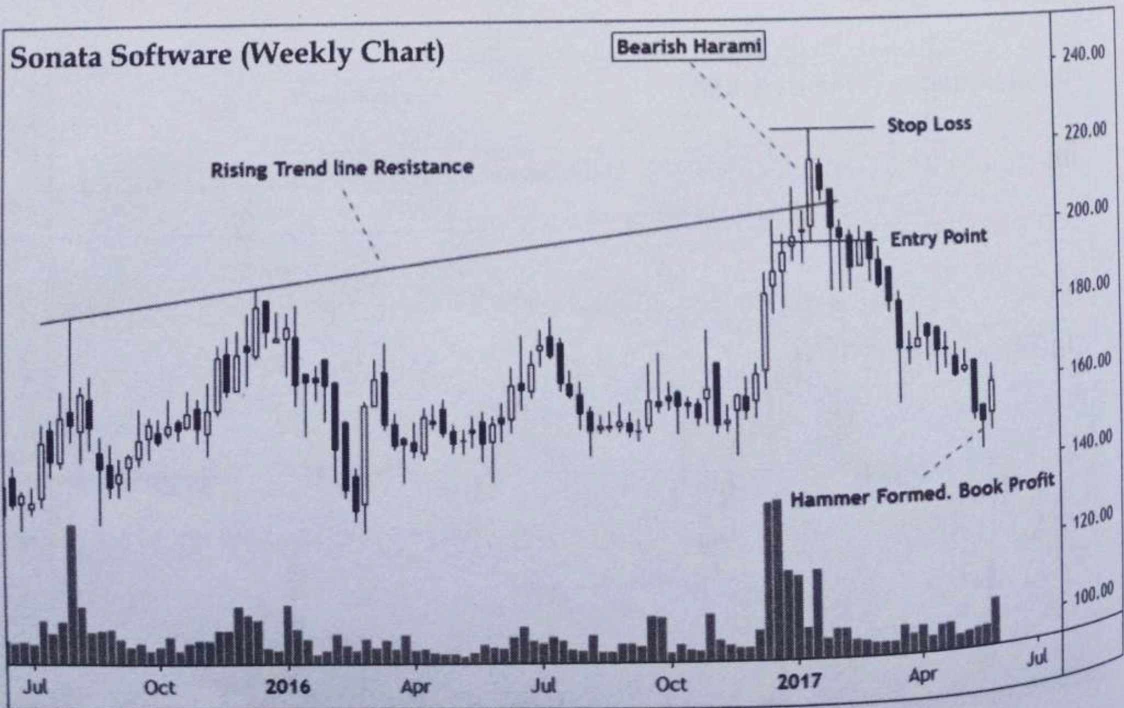


On reaching the rising trend line after a strong bullish momentum, in the week starting on 16th January 2017 a long body bullish weekly candle was formed. This was followed by a small body bearish weekly candle such that it resulted in a Bearish Harami Pattern as shown in the chart above.

The volume of the first bullish candle was greater than the previous candle and the volume of the second bearish candle was lower than the previous few candles. This gives a good indication of reversal on cards.

Now, a short entry can be taken below 195.80 (low of the pattern) and stop loss is placed above 224 (high of the pattern).

The stock started correcting forming a series of bearish weekly candles and in three months the stock corrected from 195 to 143. A hammer was formed as shown in the chart below which indicates towards a bullish reversal. This is where it is advised to book profits.

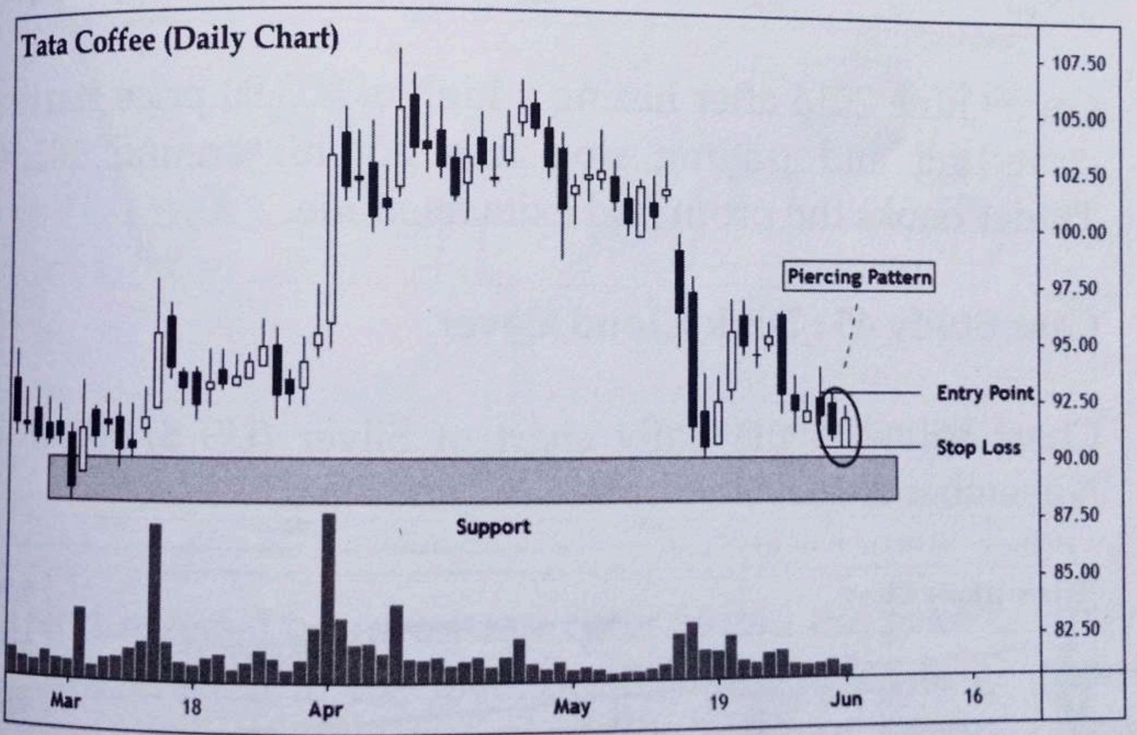


A trader can easily book profit on 29th May 2017 after the trading starts i.e., somewhere around 152 – 153 levels.

Case Study 44 : Piercing Pattern

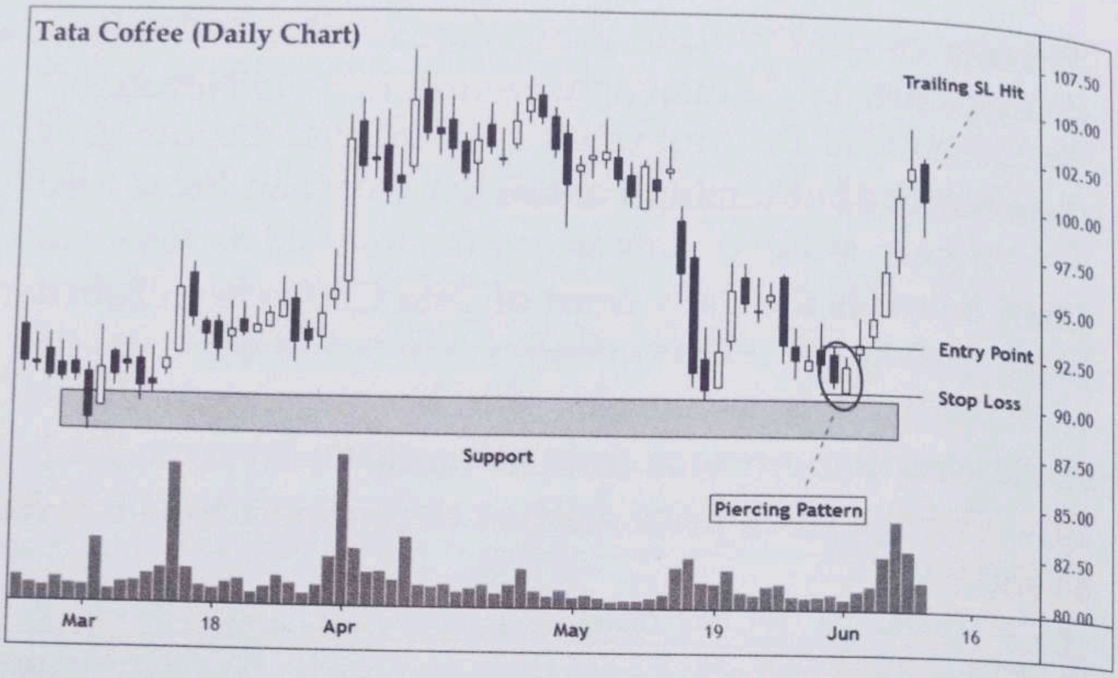
Chart below is the daily chart of Tata Coffee from February 2014.

A Piercing Pattern was formed on 30th May and 2nd June 2014 after the stock price reached the support zone between 88 and 90.



Now, a long entry can be taken above 92.85 (high of the pattern) and stop loss is placed below 90.50 (low of the pattern).

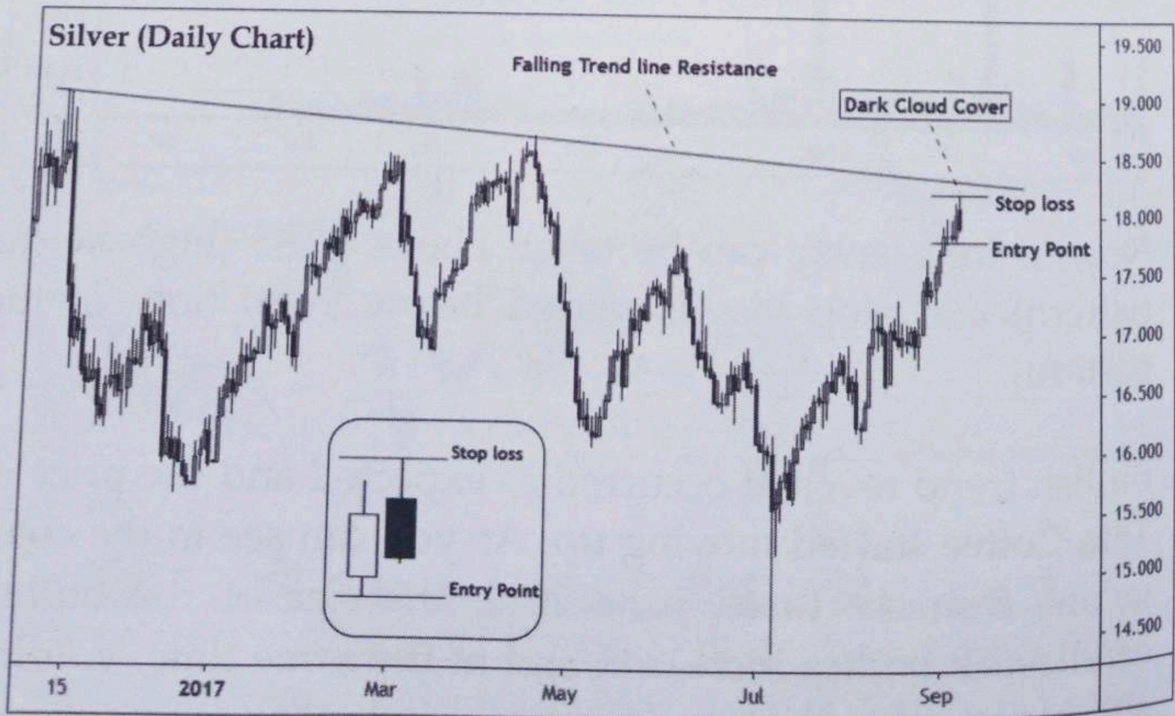
Bullish trend reversal occurred as expected and the price of Tata Coffee started moving up. As you can see in the chart below, from 4th to 6th June 2014, the size of the bullish candlestick bodies increased and at the same time, volume also increased indicating an increase in bullish momentum.



On 9th June 2014 after hitting a high of 103.90 price starting correcting and trailing stop loss got hit around 101.50. Trader books the profit and exits the trade.

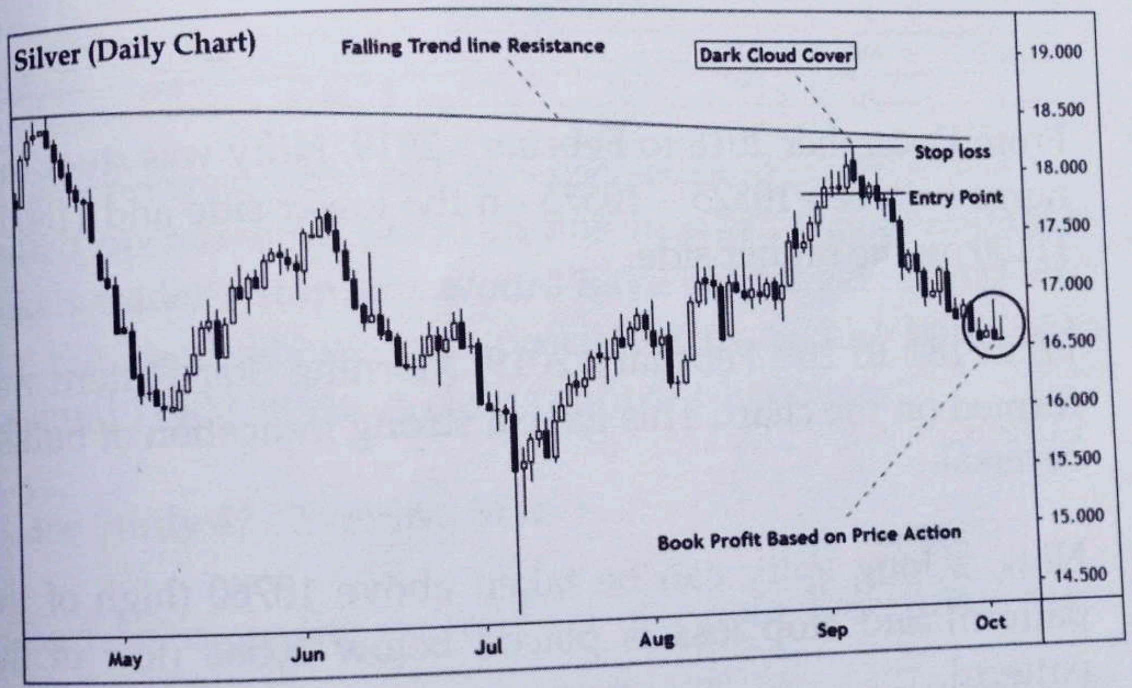
Case Study 45 : Dark Cloud Cover

Chart below is the daily chart of Silver (US $/Oz) from November 2016.



A Dark Cloud Cover Pattern was formed on 7th and 8th September 2017 after a strong up move from levels of around 15.5 US \$. This bearish reversal was formed near the falling trendline from where the price had corrected sharply twice before.

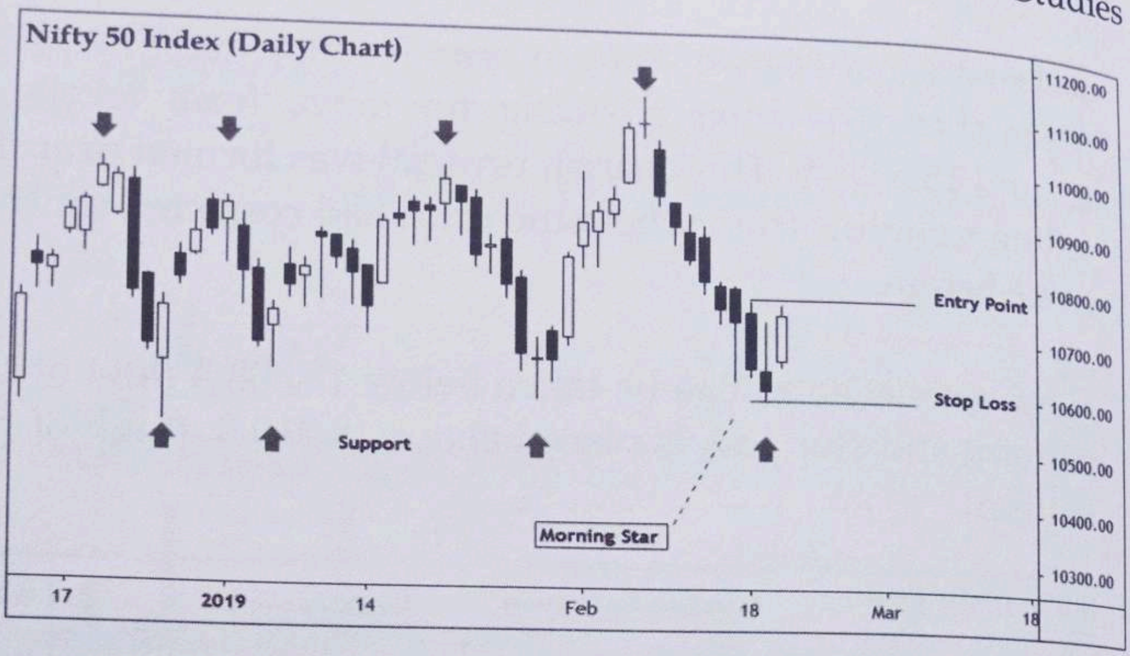
Now, a short entry can be taken below 17.808 \$ (low of the pattern) and stop loss is placed above 18.210 \$ (high of the pattern).



Trend reversal occurred as expected and the price of silver soon corrected to the level of 16.55 but failed to go down further. On 4th October 2017, an Inverted Hammer was formed indicating that reversal was on cards. The next day Gravestone Doji pattern was formed which indicated towards uncertainty. Hence looking at price action it is advisable to book profit around this level.

Case Study 46 : Morning Star

Chart on the next page is the daily chart of Nifty 50 Index from December 2018.



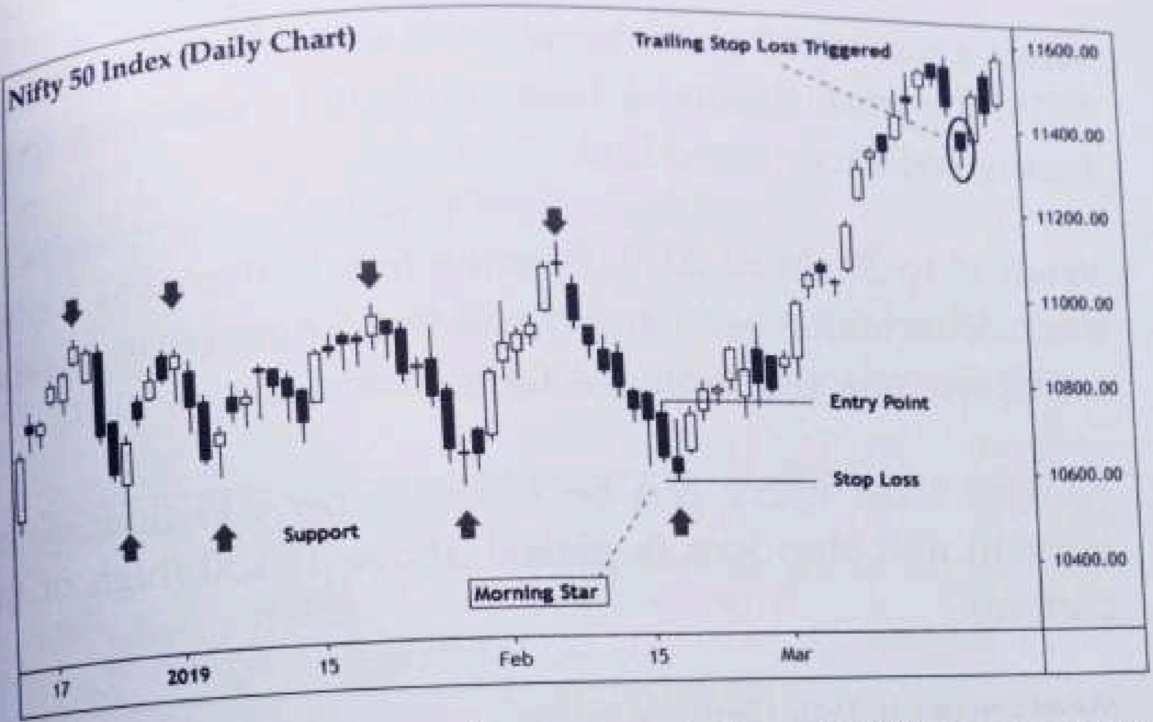
From December 2018 to February 2019, Nifty was stuck in a range between 10525 - 10575 on the lower side and 11000 - 11100 on the higher side.

From 18th to 20th February 2019, Morning Star Pattern was formed on the chart. This gave a strong indication of bullish reversal.

Now, a long entry can be taken above 10760 (high of the pattern) and stop loss is placed below 10586 (low of the pattern).

In this case, since the stop loss of 174 points is wide enough, a trader should go for a small trading position based on the size of his trading capital. Also, a target can be kept in mind which is 2 times or more than this range so that risk:reward ratio is 2 or higher. Let us assume a target of around 350 - 400 points in our mind but remember exit should be decided on the basis of trailing stop loss.

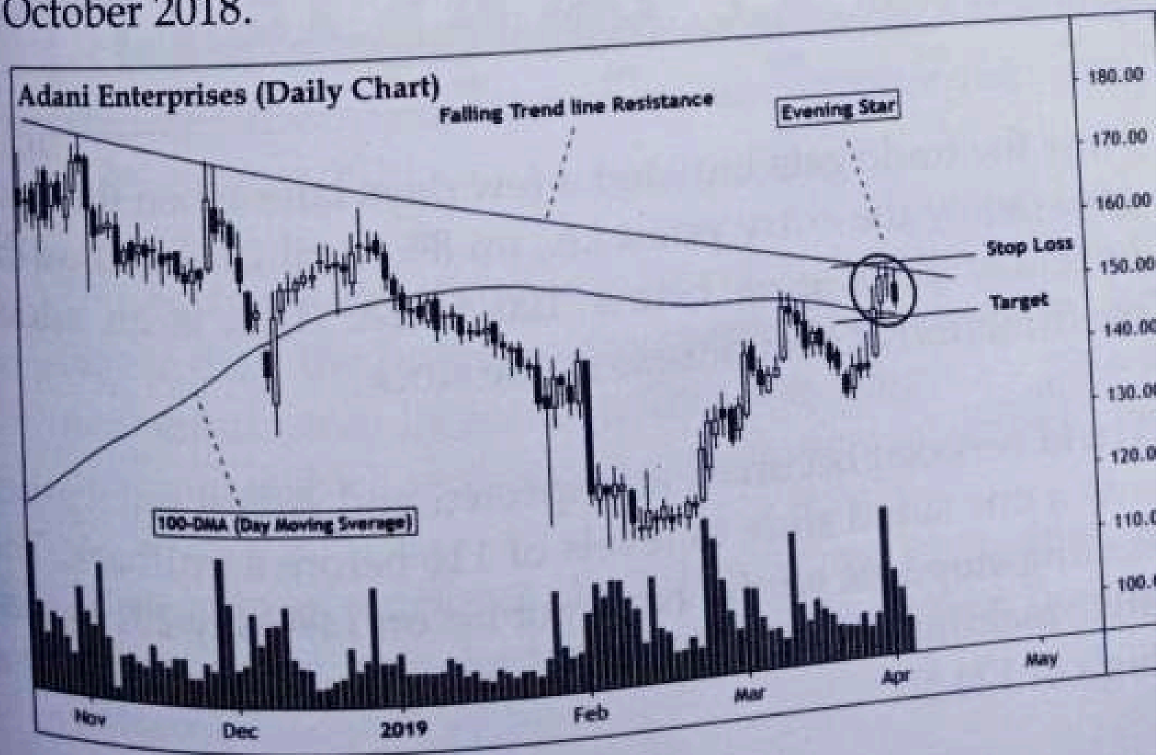
Now in the chart on the next page, let us see what happens after trading position is taken.



Trend reversal occurred as expected and Nifty saw a one sided up move till 11550 in one month's time. Now most likely trader's stop loss would have got triggered as shown in the chart above and possible exit would have been around 11400 levels. A clear profit of 640 points.

Case Study 47 : Evening Star

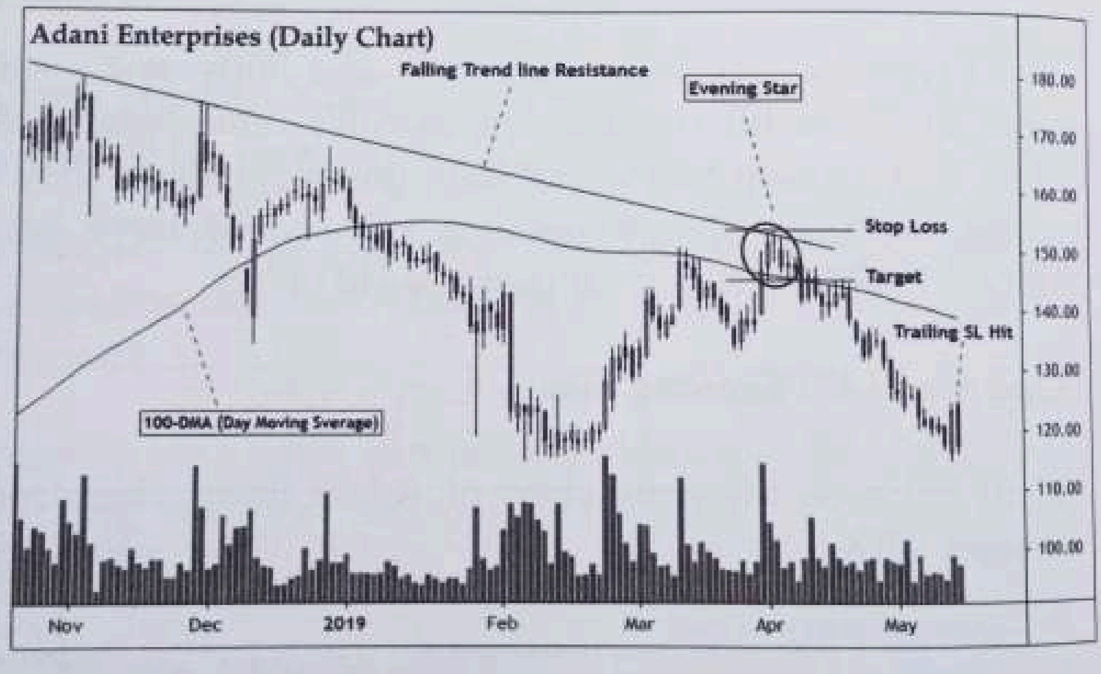
Chart below is the daily chart of Adani Enterprises from October 2018.



After a sustained downtrend from October 2018 to March 2019, the stock formed a base and made a comeback to the falling resistance trend line.

From 1st to 3rd April 2019, Evening Star Pattern was formed on the chart. This bearish reversal was formed in confluence with price rejection from the falling trendline.

Now, a short entry can be taken below 145 (low of the pattern) and stop loss is placed above 153.30 (high of the pattern).



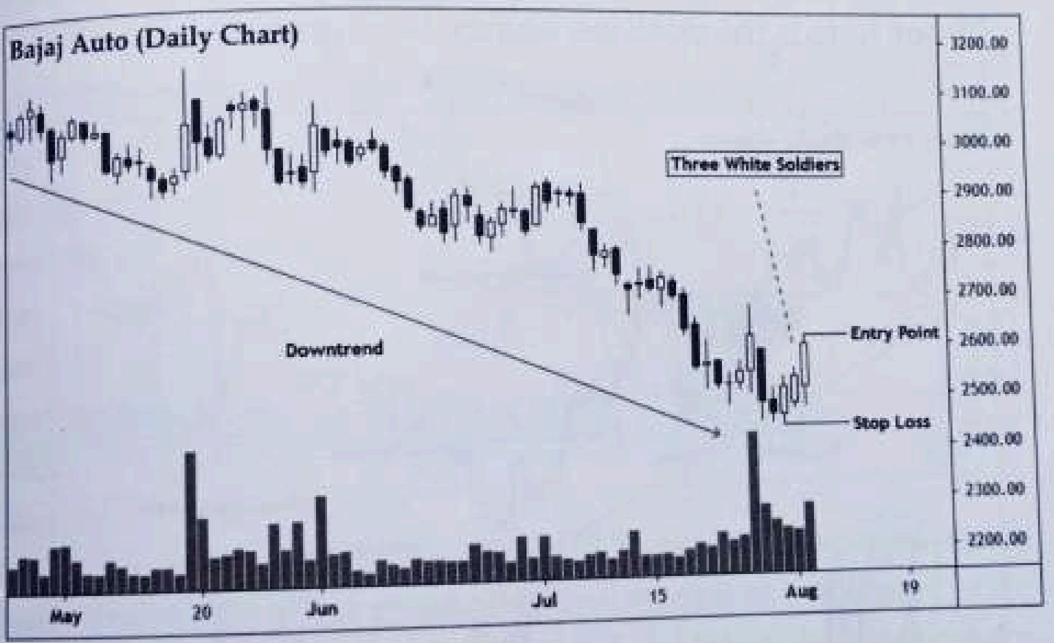
Now the trade gets initiated a few days later when the price goes below the entry point i.e., on 8th April 2019 and on the next day price goes below 100 DMA. This is an added confirmation of bearishness in the stock.

Trend reversal occurred as expected and Adani Enterprises saw a one sided slide to levels of 116 before a pullback. The trailing stop loss would have got hit on 14th May 2019 when after making a new low of 115 stock went higher and hit a high of 124.50.

A clear profit of Rs. 21 per share i.e., around 14% in around 5 weeks.

Case Study 48 : Three White Soldiers

Chart below is the daily chart of Bajaj Auto from April end 2019.



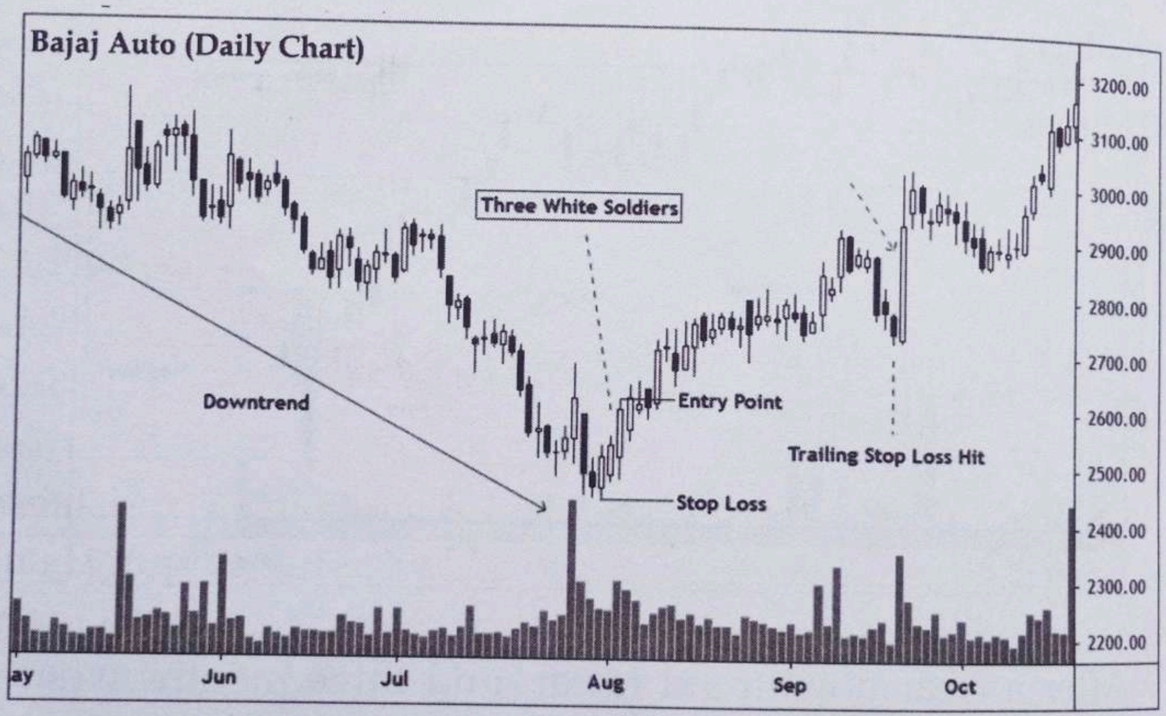
After a clear downtrend for around three months wherein price corrected from 3100 to 2450 levels, Three White Soldiers Pattern was formed on the chart from 31st July 2019 to 2nd August 2019.

The body of the third candle of the pattern was much bigger than the previous day candle indicating that bullish momentum was increasing. This was coupled with a spurt in volume which indicated a strong reversal was on cards.

Now, a long entry can be taken above 2618 (high of the pattern) and stop loss is placed below 2442 (low of the pattern).

In this case, the price slowly started moving higher before getting stuck in a range between 2725 – 2800 forming candles having smaller body just a few days after our entry.

The price crossed 2900 on 11th September 2019 and then started correcting. On 17th September 2019 a long bearish candle was formed and a few days later on 19th September 2019 trailing stop loss of traders got triggered forcing a trader to exit the position somewhere around 2745 – 2750.

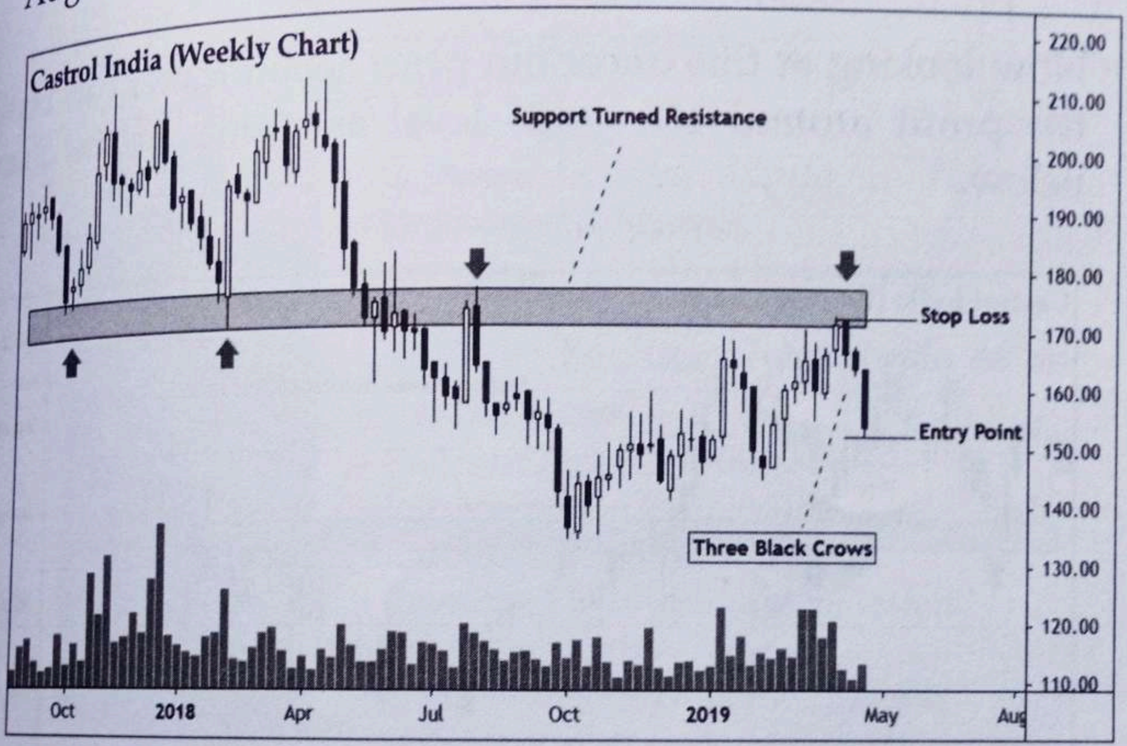


After seeing a high of over 2900 I am sure it is very painful to book profit at 2750 a few days later. But it is important to exit when trailing stop loss gets triggered. Such discipline is the main differentiating factor between a successful and an unsuccessful trader.

Unfortunately after exit, the next day itself a wide body bullish candle got formed and the price went straight from 2720 to hit a high of 3020. But again telling you never have regret for such things. It's part of the game.

Case Study 49 : Three Black Soldiers

Chart below is the weekly chart of Castrol India from August 2017.



After forming a top around 213.5 and facing resistance there, the stock price corrected and broke the support zone in May 2018. This support then became an important resistance.

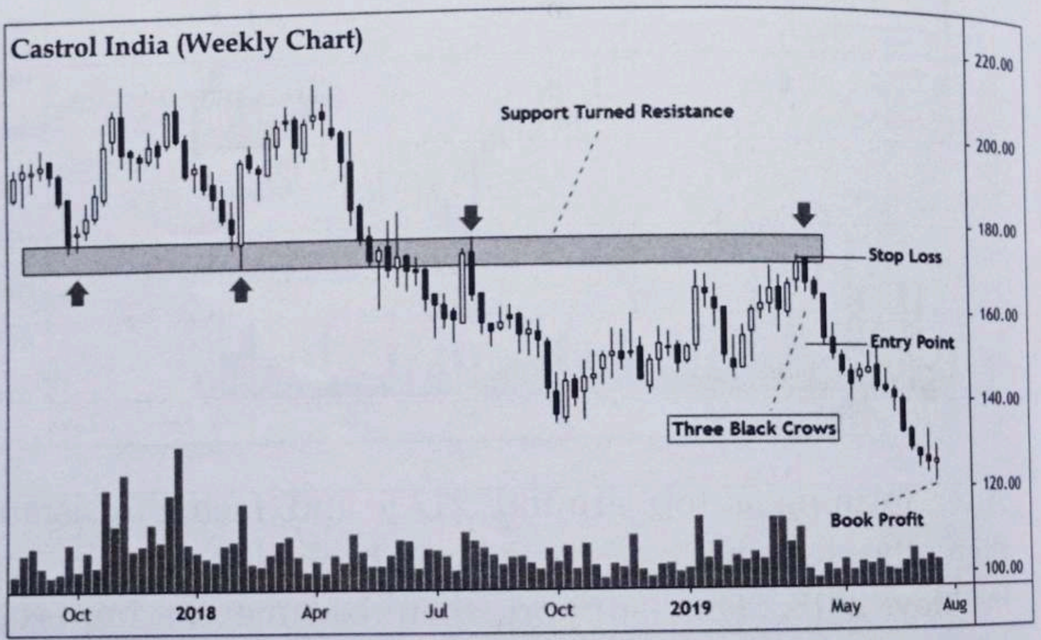
Three Black Crows Pattern was formed on the chart from 8th April 2019 to 22nd April 2019 after reversal from the resistance.

Now, a short entry can be taken below 152.35 (low of the pattern) and stop loss is placed above 172.50 (high of the pattern).

Now after a slight correction, the price gave a small pullback before starting to correct again.

After a wide bearish candle, the bearish momentum slowly reduced and then a small body long shadow candle was formed in the week starting 15th July 2019 (sign of uncertainty). Next week a doji was formed.

Now looking at this uncertain price action trader can book the profit around 126 - 128 level as shown in the chart below.



Note :

After reading all the case studies, you might have noticed that I have not provided a single case study on 5 minute or hourly chart as such time frame charts are used for intraday trading and according to me, beginners should keep away from intraday trading, at least during the learning phase of Technical Analysis.

At the same time, beginners should avoid taking leveraged positions (margin based trading) and trading in derivatives.

Sunil Gurjar (BMS, M.Com), founder of Chartmojo, has vast experience in Technical Analysis and his expertise lies in extensive use of Price Action. He was previously associated with IIFL and IndiaNivesh Securities. He is active on social media platforms as 'Chartmojo'.

Price Action Trading is a trading technique in which traders make use of only **'Price'** and **'Volume'** to make trading decisions.

This book will guide you how to trade in securities and time entry and exit in a better way using price action, without relying much on technical indicators.

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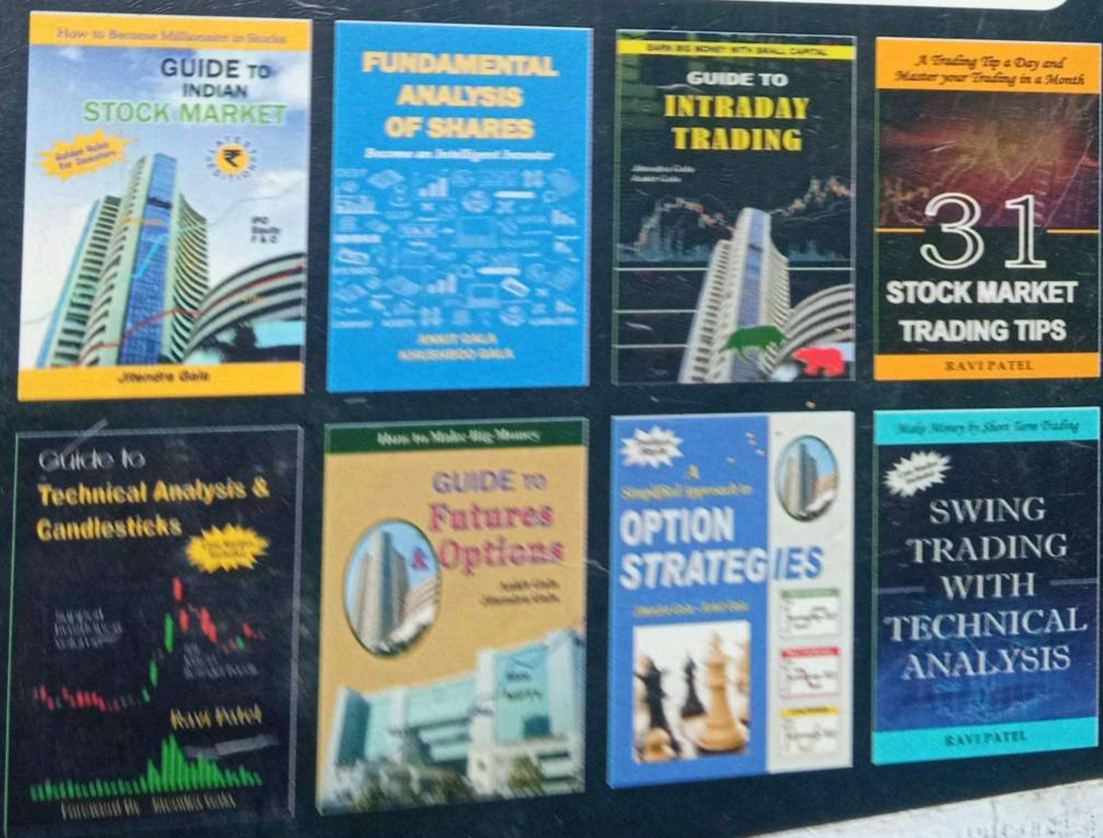

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